Inquiry into Microeconomic Reform in Western Australia

Issues Paper

Economic Regulation Authority

WESTERN AUSTRALIA

Important Notice

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Perth, Western Australia
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Foreword

The Treasurer of the State of Western Australia has requested that the Economic Regulation Authority (**ERA**) undertake an Inquiry into Microeconomic Reform in Western Australia.

In accordance with the Inquiry's Terms of Reference, the ERA will provide recommendations on the most advantageous package of microeconomic reform measures that the Western Australian Government could implement to improve the efficiency and performance of the Western Australian economy.

The purpose of this Issues Paper is to provide background information and outline the issues to be considered. It is intended to assist stakeholders in understanding the nature of the issues under review and to facilitate public comment and debate.

Responses on any matter, including those raised in this Issues Paper, should be submitted by 4:00 pm (WST) on Friday, 13 September 2013, preferably in electronic form, and addressed to:

Economic Regulation Authority

Inquiry into Microeconomic Reform in Western Australia

Email address: publicsubmissions@erawa.com.au

Postal address: PO Box 8469, PERTH BC WA 6849

Facsimile: (08) 6557 7999

Section 1 of this Issues Paper provides further information regarding the process for making a response to the ERA. Interested parties and stakeholders will have further opportunities to make submissions following the release of the ERA's Discussion Paper and Draft Report.

The Final Report for this Inquiry is scheduled to be delivered to the Treasurer on 30 June 2014, following which the Treasurer will have 28 days to table the report in Parliament.

I encourage interested parties to consider the Terms of Reference and matters raised in the Issues Paper and prepare by either a full formal submission, provide the ERA with a brief email of your ideas for the Inquiry.

LYNDON ROWE
CHAIR

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Introduction

1.1 Terms of Reference

The Treasurer of Western Australia has given written notice to the ERA to undertake an Inquiry into Microeconomic Reform in Western Australia.

The Terms of Reference for the Inquiry require the ERA to develop the most advantageous package of microeconomic reform measures that the Western Australian Government could implement to improve the efficiency and performance of the Western Australian economy, with a focus on areas of reform that have the potential to achieve the following outcomes:

- improved productivity and flexibility of the Western Australian economy;
- increased choice for consumers and business, leading to net economic benefits to Western Australia;
- increased opportunities for Western Australian businesses to effectively compete for national/international market share; and
- removal or streamlining of unnecessary regulation.

In developing its recommendations, the ERA is required to:

- assess the current level of efficiency of Western Australia's economy, including a comparison with other relevant national and international economies;
- identify those areas in the economy where reform could enhance their contribution to the overall Western Australian economy;
- identify options for improving the economic efficiency of the key areas identified above;
- prioritise key areas of reform based upon their potential impact on overall economic efficiency and future growth; and
- recommend a small number of specific key reforms or sectors that require further investigation by the ERA and/or policy development by the Government.

1.2 Public Consultation

This will be the first Inquiry into microeconomic reform undertaken by the ERA and, as such, the ERA seeks to consult extensively with the public in developing its recommendations.

The ERA invites you to provide either a formal submission, or a brief email, on matters of relevance to the Terms of Reference and this Issues Paper. Submissions and emails are due by 4:00 pm (WST) on Friday, 13 September 2013. All submissions and emails received will be considered by the ERA.

This Issues Paper is intended to assist you in preparing your response to the ERA. It provides information on:

- the inquiry and response processes;
- the objectives of microeconomic reform;
- the ERA's intended approach to the Inquiry;
- past microeconomic reforms in Western Australia and Australia;
- the responsibilities of the Western Australian Government; and
- the Western Australian economy.

Chapters 2, 3 and 4 of the Issues Paper provide an overview of the matters on which the ERA is seeking responses, with a list of specific questions for interested parties being provided in Chapter 7. Chapters 5 and 6 provide background information that may assist you in understanding the broader context within which potential reforms may be implemented.

1.3 Inquiry Process

This Issues Paper seeks both formal submissions, and comments via email, on the potential reforms that the ERA could consider during the Inquiry, including comments on the benefits to be gained from specific reform initiatives. The ERA is also seeking feedback on other factors, including the most appropriate approach to evaluating the net benefits of particular reforms.

After reviewing the responses received to this Issues Paper, the ERA will publish a Discussion Paper.

In contrast to this Issues Paper, the Discussion Paper will provide more detail on specific issues and opportunities for reform, and will seek more detailed submissions on those topics. Detailed analyses of potential reforms will be sought in response to the Discussion Paper.

The ERA will then publish a Draft Report on its website, and will invite further public submissions in response. These submissions will be considered in the preparation of the ERA's Final Report, which will be presented to the Treasurer by 30 June 2014. The Treasurer will then have 28 days to table the Final Report in Parliament.

In accordance with section 45 of the *Economic Regulation Authority Act 2003*, the ERA will act through the Chair and members in conducting this Inquiry.

1.4 How to Make a Response

Your response may be provided in written or electronic form and addressed to:

Inquiry into Microeconomic Reform in Western Australia
Economic Regulation Authority
PO Box 8469
Perth Business Centre
PERTH WA 6849
Email: publicsubmissions@erawa.com.au
Fax: (08) 6557 7999

Responses must be received by 4:00 pm (WST) on Friday, 13 September 2013.

Responses will be placed on the ERA's website unless confidentiality is claimed. The response, or parts of the response in relation to which confidentiality is claimed, should be clearly marked. Any claim of confidentiality will be dealt with in accordance of Section 55 of the *Economic Regulation Authority Act (2003)*.

2 Microeconomic Reform

2.1 What is Microeconomic Reform?

'Microeconomics' refers to the economic behaviours and choices of individuals, households and businesses. It considers the way people in a society choose to buy, sell, make, invest in, and use goods and services. It differs from macroeconomics, which considers how the economy works as a whole using measures such as unemployment and inflation.

A macroeconomic policy is one intended to modify the way in which an economy works as a whole. Macroeconomic policy decisions may include raising or lowering interest rates, running a budget surplus or deficit, or carrying out an economic stimulus plan. These issues are outside of the scope of this Inquiry.

In contrast, a microeconomic reform is any government policy decision that changes the way in which people choose to produce, exchange, invest in, or use specific goods and services. An effective microeconomic reform is one that encourages more efficient use of the resources available in an economy. These resources may include the economy's workforce, infrastructure, technology, knowledge, land, and raw materials.

Historically, microeconomic reform in Australia has focused on deregulation (a lowering of government involvement). However, microeconomic reform encompasses more than this, and may address areas as diverse as taxes and tariffs, the development and management of public infrastructure, workplace relations legislation, and public investment in science, health and education. Some examples of microeconomic reform include:

- the deregulation of an industry;
- the introduction of a new industrial relations framework;
- the reduction or removal of a duty or tariff;
- public investment in education or training;
- the introduction of legislation to prevent price-fixing or other anti-competitive behaviour;
- the introduction of legislation to allow competing businesses access to State infrastructure such as rail networks and ports;
- the subsidisation of an industry or service that would not adequately be provided by the market – for example, emergency services;
- the introduction of a tax or levy on industries that imposes costs on communities – for example, heavy polluters;
- public investment in research and development in a specific industry; or
- a change to the operation of the taxation system.

Section 3 provides some further examples of reforms that have been undertaken previously in Western Australia.

This Inquiry requires the ERA to recommend a package of reforms that will benefit the State by allowing Western Australians to make better use of existing resources, skills, and opportunities. It also provides stakeholders with a chance to contribute to this process by responding to the ERA on the points raised in this Issues Paper, and subsequently on those that will be raised in the Discussion Paper and Draft Report.

2.2 The Benefits of Undertaking Microeconomic Reform

Effective microeconomic reforms encourage individuals and businesses to make choices that are not only financially rewarding on a personal level, but are also beneficial to the wider economy. Reforms can promote productivity growth that generates higher incomes and government revenues, which are needed to raise living standards.

2.2.1 Efficiency

Effective microeconomic reforms bring about gains in economic efficiency, resulting in better use of the economy's existing resources, either by increasing production or by freeing up resources that might be employed more effectively elsewhere. This results in increased production capacity which will, in general, result in higher levels of production.

Efficiency is often thought of as productivity, but economic efficiency is a much broader concept. There are a number of considerations in achieving economic efficiency. These include:

- providing goods and services at the least cost (that is, 'productive efficiency' or 'technical efficiency'), which can be achieved by using the most efficient, least-cost production technologies or by adopting management methods that reduce costs, without compromising service standards;

- allocating resources to their most productive use (that is, 'allocative efficiency'), which can be achieved by setting the prices of goods and services to reflect the cost of providing an additional unit of the good or service; and

- ensuring that investments are optimal over the long-term, in both timing and location (that is, 'dynamic efficiency'). For example, investments should ideally be timed so that costs are minimised in the long-term, and accommodate changes in consumer preferences and technology over time.

While competitive markets without government intervention can often give the best outcome in terms of economic efficiency, this is not always the case. For example, in cases where significant costs are borne by external parties (for example, where disposal of factory waste impacts the health of local residents), the Government may enact legislation to resolve the problem. This ensures that all costs and benefits are taken into account, including external costs and benefits.

2.2.2 Flexibility

In addition to improvements in efficiency and productivity, effective microeconomic reforms can also increase an economy's flexibility and resilience in the face of economic and technological change. As mentioned above, reforms may make resources available for other purposes, allowing industries to take advantage of new opportunities, or to invest in research, development, and innovation. A key benefit of flexibility is the ability to weather economic shocks, as observed in Australia during the 1997 Asian Financial Crisis, and the 2008 Global Financial Crisis.

2.3 Costs and Challenges of Microeconomic Reform

While well-designed microeconomic reforms may deliver significant benefits, they can also be complex, challenging to implement, or cause initial adjustment costs to be incurred. Additionally, a government's role will include the consideration of social welfare and equity (including equity between regions, different social groups, or current and future generations), issues that are beyond the scope of this Inquiry. Consequently, the design and implementation of reforms can be a substantial undertaking, even in cases where there is a clear future benefit to be achieved.

In preparing your response, it may be useful to consider the costs, challenges, and probable benefits of the reform, and more broadly, to address any practical issues that may arise during the implementation of any specific reform. Examples of these considerations may include:

- the likely costs of implementing the reform, including adjustment costs;
- the complexity of assessing the value of the reform;
- the likelihood that the benefits of the reform may be spread inequitably across society, particularly in cases where one particular group may bear the majority of the costs, or be substantially disadvantaged;
- whether the reform is likely to result in increased regulatory costs; and
- whether the reform will require significant changes to existing legislation, or the introduction of new legislation.

3 Microeconomic Reform in Australia

3.1 Past Microeconomic Reform in Australia

3.1.1 National Reforms

Since the early 1970s, Australia has seen the introduction of a broad range of Federal reforms, which have, directly or indirectly, impacted Western Australia, spanning many parts of the economy. Selected examples include:

- Education: tertiary education fees were abolished in 1972 to make education more widely available. In 1989, fees were reintroduced with the Higher Education Contribution Scheme;
- Health: Medibank was introduced in 1975, removed in 1976, and reintroduced as Medicare in 1984;
- Tariffs: there were tariff cuts of 25 per cent across industries in 1973, and a range import quotas were removed (or in the case of agriculture, replaced by tariffs) during the 1980s and early 1990s;
- Transport: Australia's major commercial ports were corporatised, resulting in these ports operating as commercial entities;
- Water: in 2004, the National Water Initiative established a national agreement for managing water supply issues and drainage;
- Labour Market: a number of pieces of legislation passed between 1996 and 2009 implemented changes to the award system and employment terms, introduced the Fair Work Commission, and facilitated collective bargaining;
- National Competition Policy: the introduction of a policy in 1995 to achieve the most efficient delivery of publicly provided goods and services, along with the recommendation of reforms to minimise restrictions on competition;
- Agriculture: the introduction of the Rural Adjustment Scheme, deregulation of domestic marketing, removal of administered pricing and compulsory acquisition of grain by the Australian Wheat Board;
- Energy: the creation of the National Energy Targets and the Wholesale Electricity Market.

A more detailed, although not exhaustive, list of Federal microeconomic reforms has been provided in Appendix 2.

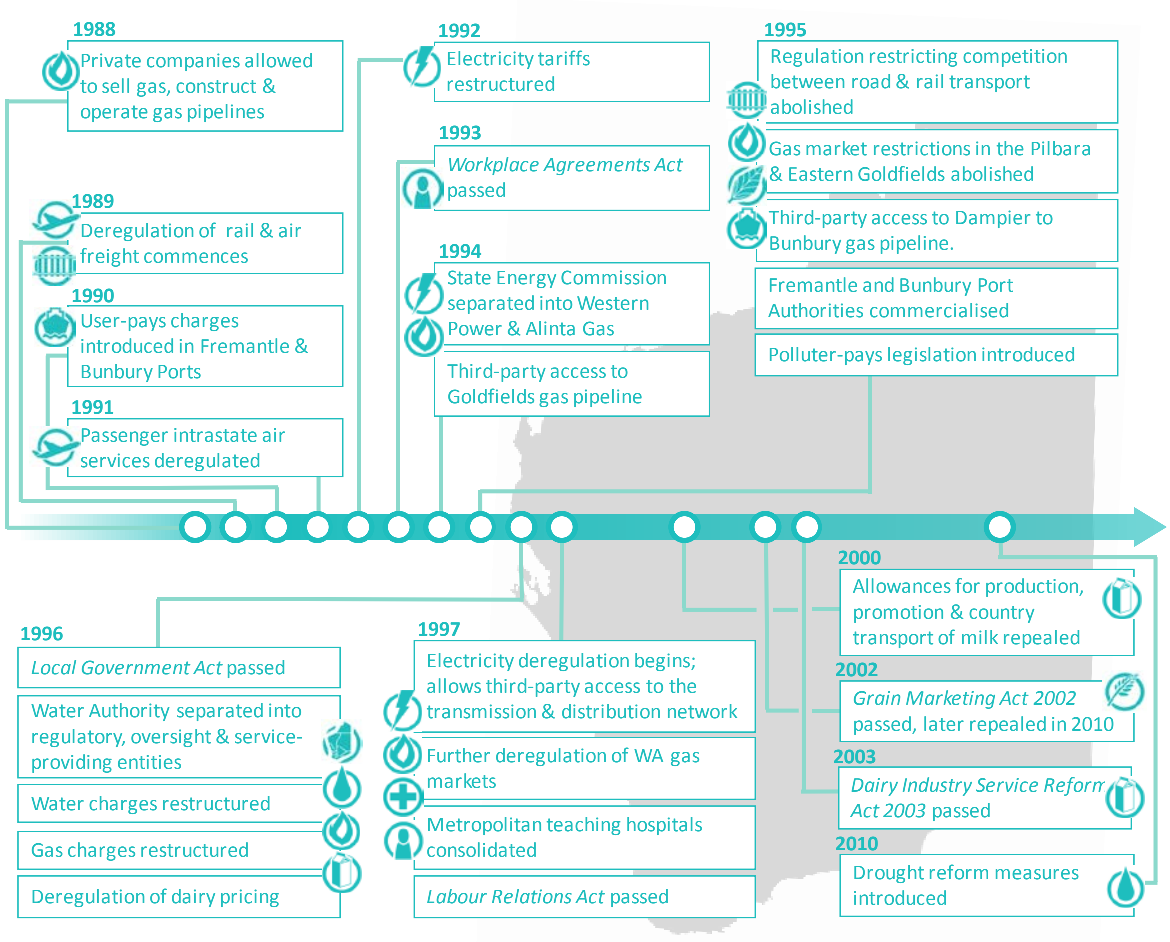
3.1.2 Western Australia

Prior to the 1980s, the reforms with the greatest impact upon Western Australia were driven by Federal Government policy. Between 1972 and 1975, the Federal Government introduced changes such as the introduction of the *Trade Practices Act*, the establishment of Medibank (the precursor to Medicare), and extensive changes in education policy.

Following this period, during the 1980s and 1990s Western Australia saw the introduction of significant State-driven reforms across many sectors. National Competition Policy reforms undertaken between 1995 and 2005 also drove considerable State-level changes.

Prior to the reforms, many segments of the transport industry were fully regulated, and third-party access to key infrastructure was often limited, including access to gas pipelines, electricity distribution networks and rail networks. The reforms were largely aimed at introducing competition, deregulating industries and allowing the entry of private firms. This period also saw the introduction of legislation to change the State's local government and workplace relations frameworks. A timeline showing some of the larger reforms is provided in Figure 1.

Figure 1 Timeline of Microeconomic Reform in Western Australia



While many of the reforms outlined above relate to the deregulation of various sectors of the economy, some have worked to increase competition and private investment by introducing additional regulation.

In some cases, regulation has been established that requires the owners of key infrastructure to allow third-party access. This has meant that new investors, particularly in the resources sector, can pay for access to infrastructure allowing them to transport or distribute their product. Further, it has reduced the need for new investors to unnecessarily construct duplicate infrastructure, where the existing infrastructure has unutilised capacity.

Prior to 2006, industrial relations was a substantial State responsibility. However, in the Commonwealth Government's *Workplace Relations Amendment Act (WorkChoices) 2005*, many of the State's workers were brought under the Federal industrial relations umbrella. While many of the changes in WorkChoices were repealed by the subsequent Commonwealth Government through the introduction of the *Fair Work Act 2009*, the degree of centralisation was not reversed.[1]

3.2 Impacts of Microeconomic Reform in Australia

The importance of microeconomic reform can be illustrated through Australia's resilience during global downturns. During the 1990s, Australia was frequently referred to as an 'economic miracle' for its ability to withstand the Asian Financial Crisis and achieve strong levels of economic growth. The Organisation for Economic Co-operation and Development attributed Australia's productivity and development during this period to the reforms undertaken in Australia during the 1980s, stating that the reforms had substantially improved the competitiveness, flexibility and resilience of the Australian economy.[2]

While macroeconomic management likely played some role in providing a more stable and predictable climate for investment and production decisions, microeconomic reforms are more often cited as the key to Australia's strong performance since the acceleration of these reforms in the 1980's. These microeconomic reforms provided productivity incentives for businesses, removing barriers to competition and trade, allowing for greater flexibility to adjust to increased competition, and developing Australia's capacity to innovate in production methods and product markets.

Gary Banks, former Chair of the Productivity Commission, agreed that Australia's economic resilience was actually the outcome of deliberate policy reforms that resulted in the longest period of continuous growth in productivity, and the strongest underlying rate of productivity growth, on record.[3] These reforms resulted in a large increase in Australia's capacity to produce goods and services from its available resources, which in turn resulted in a total increase in household income of approximately $7,000 per household over subsequent years.

Furthermore, the Productivity Commission has found that microeconomic reforms have had long-term influences on Australia's economy, and on the standard of living of its citizens.[4] The Productivity Commission found that cumulatively between 1995 and 1999, the direct impacts of the National Competition Policy reforms increased Australia's Gross Domestic Product (**GDP**) by 2.5 per cent, or $20 billion.[5] Further, since the tariff liberalisation of the mid-1980s, real wages in Australia have increased by one-third in real terms.[6]

[1] The Western Australian Department of Commerce estimates that up to a third of Western Australian workers are still under the State system at the present time.

[2] Organisation for Economic Co-Operation and Development, 2003, *OECD Economic Surveys 2002-2003 Australia,* France.

[3] Banks, G, 2002*, Micro Reform's Productivity Payoff*, The Australian.

[4] This has been referred to in Banks, G, 2002*, Micro Reform's Productivity Payoff*, The Australian., Banks, G, 2012, *Advancing the Reform Agenda: Selected Speeches, Productivity Policies: the 'To-do' List*', and The Productivity Commission, (2006), *Potential Benefits of the National Reform Agenda,* Report to the Council of Australian Governments, Australia, pg.16.

[5] Productivity Commission, 2005, *Review of National Competition Policy Reforms*, pg.xvii.

[6] Banks, G, 2012, *Productivity Policies: the 'To-do' List,* Economic and Social Outlook Conference.

Benefits can also be seen at the industry level. For example, the abolition of the 'two airline policy' in the domestic aviation industry in 1990 contributed to lower airline prices, an increase of approximately 75 per cent in passenger numbers, and an increase in employment of 19 per cent by 1996.[7]

Studies have also indicated the high potential benefits that might be gained from a number of proposed reforms:

- A 5 per cent gain in productivity in the health sector (through administrative and human services gains) would result in a saving of $4 billion in Government spending[8]; and

- the tax reforms suggested by the Australia's Future Tax System Review (the Henry Review) could raise Australia's Gross Domestic Product by 2-3 per cent.[9]

Australia experienced high levels of Total Factor Productivity[10] (**TFP**) growth during the 1990s, a trend that has been attributed to the Federal Government's widespread microeconomic reforms during the mid-1980s.[11] These reforms were implemented to induce greater levels of flexibility, responsiveness, efficiency, and globalisation in the Australian economy. However, Australia's rate of productivity growth has declined over recent years, with the Productivity Commission attributing this to:

- temporary factors, such as the inflexibility of businesses to be able to reduce labour and capital resourcing levels during times of low demand;

- global economic circumstances and exchange rates;

- structural factors, such as the development of less profitable mining deposits that require additional labour and physical capital input per unit of output;

- an increase in inputs due to the enhancement of environment, safety and reliability factors, which have not resulted in commensurate increases in output; and

- slow or negative TFP growth in manufacturing, and in finance and insurance services.[12]

While TFP growth can be measured at the national level, the Australian Bureau of Statistics does not assess the value of private assets on a State basis. This means that it is not possible to calculate TFP for the State. Consequently, while Federal reforms can be assessed in light of increases to TFP, it is difficult to assess potential State reforms on the same basis, and so to quantify the way in which the capital intensive nature of specific industries (for example, the mining industry) may impact the State's productivity measures.

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[7] The Australian Government, 1998 *The Benefits of Microeconomic Reform*, Australia.

[8] The Productivity Commission, (2006), *Potential Benefits of the National Reform Agenda,* Report to the Council of Australian Governments, Australia, pg.16.

[9] Henry, K., Harmer, J., Piggot, J., Ridout, H. and Smith, G, (2010), *Australia's future tax system: Report to the Treasurer,* Australia, pg. 20.

[10] Total Factor Productivity (**TFP**), includes the contribution of both labour and capital

[11] Productivity Commission, 1999, *Microeconomic Reforms and Australian Productivity: Exploring the Links,* Australia, pg.18.

[12] Productivity Commission, 2013, *Productivity Update: May 2013,* Australia.

4 The ERA's Approach

As indicated in Section 2, microeconomic reform is a wide-ranging topic that provides opportunities to examine many specific areas. In conducting this Inquiry, the ERA is subject to time and resourcing constraints, and recognises that these make it impractical to perform a constructive review of all sections of the economy. However, the Terms of Reference (provided in Appendix 1) have established this as a Standing Inquiry, to be repeated every four years. The ERA considers that future Inquiries in this area will provide opportunities to investigate potential reforms in areas not explored in this initial Inquiry.

4.1 The Aim of Microeconomic Reform

In considering the role of microeconomic reform more broadly, it is important to note that microeconomic reform is focused on producing gains in efficiency, rather than in directly establishing equity. As pointed out by Gary Banks, "a *government cannot redistribute what its economy does not produce. Productivity growth is fundamental to this."* [13]

The ERA concurs that the primary goal of microeconomic reform is to increase the productive capacity of Western Australia's economy rather than considering social equity. As Banks has stated above, microeconomic reform is one step on the path to improving the overall wellbeing of society.

While the ERA has been directed to investigate microeconomic reform in this Inquiry, it should be noted that economic efficiency is but one of a number of factors that are taken into account by the Government in developing policy and legislation. This Inquiry is intended to assist the Government in gaining a comprehensive understanding of this particular factor (that is, economic efficiency) so as to facilitate the decision-making process.

As illustrated in Figure 2, potential reforms can be assessed in terms of the benefit they are likely to deliver, and the ease with which they can be justified and implemented. This second factor is partially dependent on the cost of the reform, but is also dependent on any legal, regulatory, or other practical concerns that may impact the implementation.

4.2 The Compensation Principle

Microeconomic reform often involves winners and losers. The general principle applied when considering a microeconomic reform is that it is worth pursuing if those made better off by the reform could theoretically compensate those made worse off by the reform.[14] This is known as the *Compensation Principle,*[15] and is intended to make clear the distinction between economic efficiency and equity, these being separate policy goals overseen by Government.

[13] Banks, G, 2012, *Advancing the Reform Agenda: Selected Speeches, Productivity Policies: the 'To-do' List* pg.6.

[14] While any mechanisms of compensation, should the reform be implemented, are a matter for Government, there is no legal requirement for compensation to be paid to the losers.

[15] More formally, this is known as the Kaldor-Hicks Compensation Principle, which encompasses a less strict criteria than Pareto Efficiency, which stipulates that a change is worthwhile only if it makes at lease on party better off but none worse off.

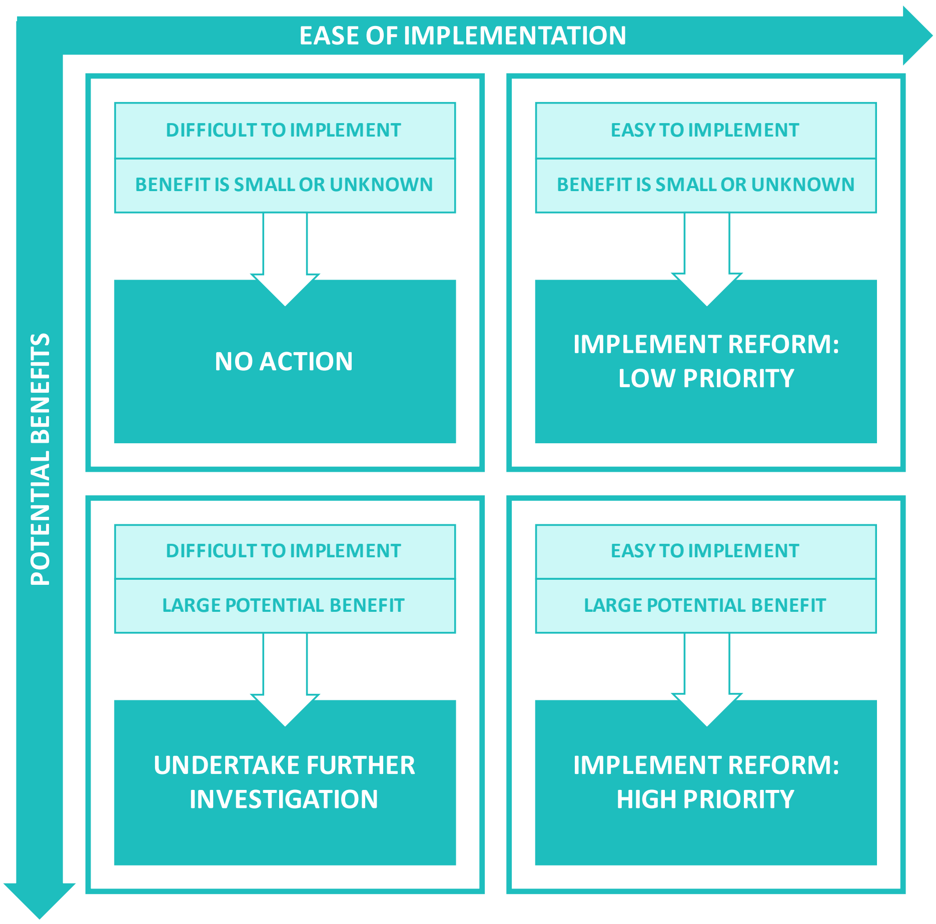
The Compensation Principle has been widely applied in economic reform undertaken over the past 40 years in Australia, in identifying reforms where the overall benefits outweigh the overall costs.[16] For example, the removal of tariffs and import restrictions from the 1970s to the 1990s caused losses for some existing domestic manufacturers, but led to gains for Australian consumers (including industries using manufactured goods as inputs), for a net gain to the economy.[17]

The ERA welcomes responses from interested parties as to how it might best evaluate specific reforms, so as to identify those reforms where the overall benefits are likely to outweigh the overall costs.

4.3 Practical Considerations

Given the practicalities of time and resources available for this Inquiry, the ERA intends to be pragmatic in its choices of reforms to recommend. Some opportunities for reform may be identified that are relatively straightforward to implement, and will deliver a significant benefit relative to the cost and effort of implementation. Such areas will be the highest priority areas for reform. Other reforms may be similarly straightforward to implement, but offer a smaller overall benefit. While there may be merit in pursuing these reforms in the future, they are a lower priority than those that are likely to deliver a greater return. The ERA's proposed approach to assessing opportunities for reform is illustrated in Figure 2.

Figure 2 Assessing Opportunities for Reform



[16] Productivity Commission, 2013, *On efficiency and effectiveness: some definitions,* Australia.

[17] Productivity Commission, 2000, *Review of Australia's General Tariff Arrangements,* Australia.

The ERA also expects to encounter some areas where there are opportunities for reform that are likely to deliver an overall benefit, but where the analysis and implementation required is particularly substantial or complex. In these cases, the ERA will generally recommend further investigation (whether by referral of a specific Inquiry to the ERA, or by Government) rather than recommending specific reforms.

In summary, rather than attempting to provide an exhaustive list of reforms, the ERA will focus on two key areas:

- the delivery of an initial package of high-priority, relatively straightforward reforms that are likely to deliver a clear benefit; and

- the development of an analytical approach that will allow for a constructive assessment of the value of any future reform.

4.4 Assessing the Likely Benefits of Reforms

In assessing the value of a reform, it is important to consider the *net* benefit – that is, the overall benefit minus any costs incurred, consistent with the Compensation Principle. Any reforms that have a positive net benefit will be candidates for further investigation.

There are a number of methods that may be adopted to calculate the net benefit delivered by a reform. Two commonly applied methods are:

- Cost Benefit Analysis (**CBA**); that is, the estimation of future financial benefits and costs likely to be delivered and incurred as a result of a reform; and

- Computable General Equilibrium (**CGE**) modelling; that is, using historical economy-wide data to estimate how the economy might respond to a reform.

Generally speaking, CGE modelling is best suited to economy-wide changes, particularly changes in relative prices (for example, a tariff reduction). Cost-benefit analysis is usually used for smaller changes (for example, an infrastructure investment) or when the benefits are not directly valued in a market (for example, time savings through a new road or public transport system).

Given the importance of using a robust and consistent model in identifying opportunities for reform, the ERA welcomes responses on any technical approaches and models that may be applicable.

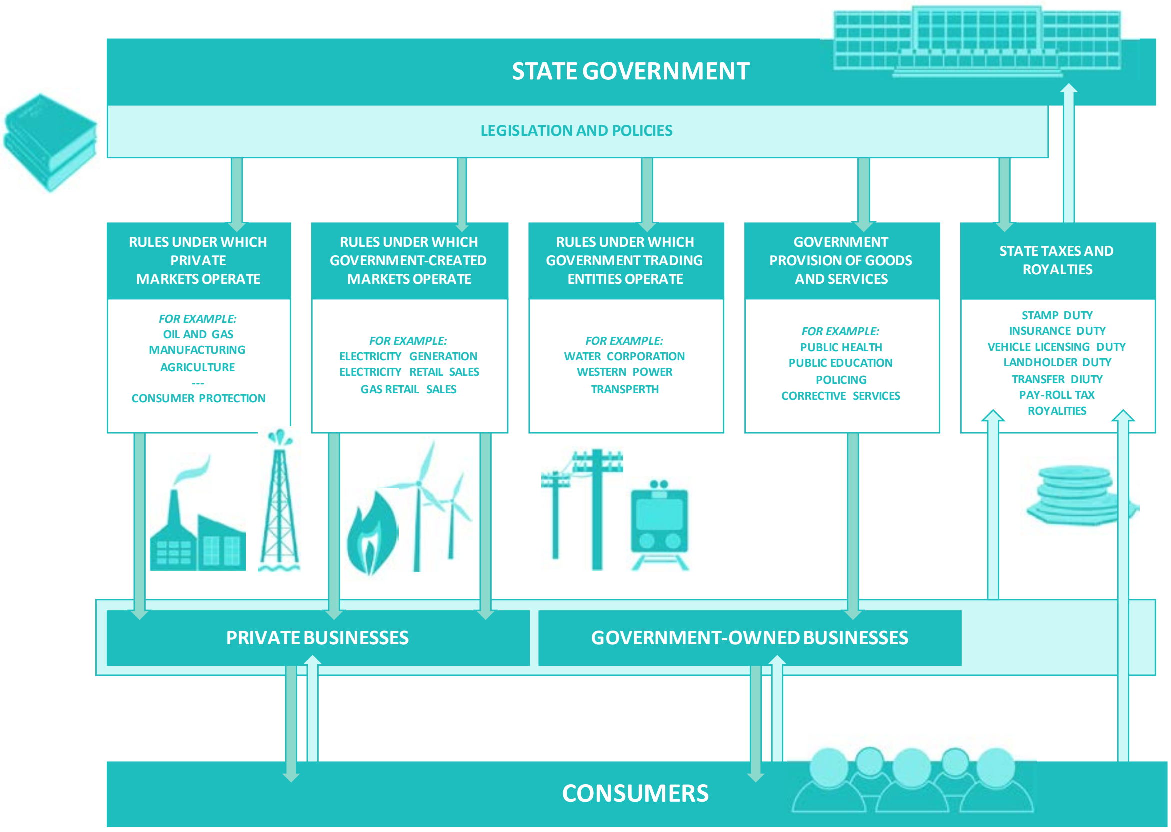
5 The Western Australian State Government

As this Inquiry is intended to assist the State Government in identifying and assessing opportunities for reform, this section provides guidance as to the division of responsibilities between the State and Federal Governments. The ERA will limit the Inquiry to areas that can be influenced by the Western Australian Government.

Figure 3 broadly illustrates areas in which the State Government has the authority to pass legislation that impacts the economy, including:

- rules and regulations that govern the regulation of markets in which private businesses operate (for example, requiring operators of certain gas pipelines and rail networks to allow third-parties access to this infrastructure);
- rules and regulations that impact the way Government-created markets operate (for example, the establishment of the Independent Market Operator to manage the State's electricity market);
- rules determining the way Government facilities and Government-owned businesses (such as Synergy and the Water Corporation) operate;
- the delivery of non-market goods and services (including public hospitals and State schools); and,
- the State's taxation framework.

Figure 3 The State Government's Responsibilities



5.1 State and Federal Responsibilities

Under the Australian Constitution, certain areas are the responsibility of the various State Governments, while other areas are managed Federally. As this Inquiry is intended to assist the State Government in developing microeconomic policy, your response should focus on the areas managed by the State, as indicated by the example in Figure 4. While the figure differentiates clearly between State and Federal responsibilities, there are often grey areas (for example, the environment) where overlapping or shared responsibilities exist.

Figure 4 Examples of the Responsibilities of State and Federal Governments

STATE GOVERNMENT	FEDERAL GOVERNMENT
• Schools	• Medicare , Centrelink & pensions
• Railways	• Immigration and customs
• Vehicle registration	• Personal Income Tax, GST, Company Tax
• Fire, ambulance and emergency services	• Air safety, passports and defence
• Hospitals	• Broadband internet
• Most roads	• Television and radio
• Police and corrective services	• Import and export regulations
• State planning	• Federal aviation
• Regulation of State industries	• Defence

The Federal Government provides further detail as to the structure of State and Federal responsibilities in Australia on its website, and a full list of the areas managed by the Federal Government is provided in section 51 of the *Commonwealth of Australia Constitution Act*. Areas that are not specifically defined in the Constitution as the responsibility of Federal Government are, by default, the responsibility of the States. However, where a conflict exists between State and Federal legislation, the Federal legislation prevails.

Additionally, Western Australia currently receives approximately one quarter of its operating revenue through Commonwealth Government grants and subsidies. This means that the State may not have full scope to change aspects of its service delivery, as the grants and subsidies may be dependent on meeting Commonwealth Government policy objectives.

5.2 Key Budget Aggregates

In addition to its policy responsibilities, the Western Australian Government also influences the State's economy and wellbeing by controlling approximately one quarter of the State's expenditure.[18] While the overall Budget balance is a macroeconomic policy and so beyond the scope of this Inquiry, the areas to which the Government allocates expenditure, as well as the efficiency and method of delivery of services, will influence the standard of living of Western Australians.

A summary of the Western Australian Government's finances is shown in Table 1. Broadly, the 'general government sector' refers to Government Departments and Agencies, while 'total public sector' captures information relating both to general government, and to publically owned corporations such as Synergy and the Water Corporation.

Table 1 Overview of Western Australian Government Finances

	2010-11	2011-12	2012-13
	Actual	Actual	Estimated Actual
GENERAL GOVERNMENT SECTOR			
Net Operating Balance ($m)	**1,604**	**649**	**239**
Revenue ($m)	23,909	25,200	25,696
Revenue Growth (%)	8.5	5.5	1.9
Expenses ($m)	22,306	24,571	25,457
Expenses Growth (%)	5.2	10.2	3.6
TOTAL PUBLIC SECTOR			
Net Debt at 30 June ($m)	12,026	14,523	18,480
Asset Investment Program ($m)	6,482	6,782	7,302
Cash Position ($m)	-2,029	-2,240	-3,677

Source: Department of Treasury, State Budget Papers: Economic and Fiscal Outlook, 2013-14.

The Western Australian Government sources approximately 75 per cent of its total revenue from the taxes and charges it levies, with the remainder coming from grants from the Federal Government. A full description of the State's taxes and charges can be viewed at the *Overview of State Taxes and Royalties* webpage.

[18] Operating cash expenditure plus purchase of non-financial assets, divided by State Final Demand. However, exact comparisons are difficult, as Government expenditure estimates in the State Budget are compiled on a different basis to those produced by the Australian Bureau of Statistics *Catalogue 5220.0*.

Table 2 provides a more detailed breakdown of all sources of Western Australian public sector revenue.

Table 2 Western Australian Total Public Sector Revenue ($m)

	2010-11	2011-12
	Actual	Actual
TAXATION REVENUE		
Payroll Tax	2,560	3,022
Land Tax	477	509
Stamp Duty	1,273	1,362
Insurance Duty	442	487
Emergency Services Levy	201	216
Motor Vehicle License Duty	338	367
Motor Vehicle Registrations	557	599
Other	615	288
Total Taxation Revenue	**6,463**	**6,850**
OTHER REVENUE		
Current Grants and Subsidies	8,003	8,678
Capital Grants	1,336	1,081
Sale of Goods and Services	15,595	17,867
Interest Income	970	924
Royalty Income	4,213	4,343
Other Income	892	954
Total Other Revenue	**31,009**	**33,847**
TOTAL REVENUE	**37,472**	**40,699**

Source: Department of Treasury, State Finances, Annual Report 2011-12.

Note: Columns may not add due to rounding.

Table 3 shows the breakdown of Federal Government grants to Western Australia, including Western Australia's portion of Goods and Services Tax (**GST**) revenue, shown in the line 'Sale of Goods and Services'. The Federal Government provides both general purpose funding to the State (including its share of GST revenue), as well as payments for specific purposes, as agreed between the Federal and State Government.

Specific purpose payments are distributed according to various Intergovernmental Agreements and Commonwealth Government priorities. The Intergovernmental Agreements are summarised on the Commonwealth Grants Commission's (**CGC's**) website.

GST revenue is distributed according to the principle of horizontal fiscal equalisation, which has the stated aim of providing each State and Territory the same ability to fund services to its residents. The stronger a State's own-source revenue, the less per-capita GST funding it will receive.

State Government forward estimates for GST revenue show annual drops of around 35 to 45 per cent in each of 2014/15, 2015/16 and 2016/17. This sharp decrease is the result of Western Australia's strong own-source revenue performance, mainly through mining royalties.

This has led to concerns[19] that Western Australia's royalty income is being distributed to other States, rather than enabling Western Australia to fund the essential services and infrastructure needs for its future economic growth.

Table 3 Federal Government Grants to Western Australia

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
GENERAL PURPOSE GRANTS						
GST Revenue ($m)	3,454	2,935	2,458	1,592	894	500
Growth (%)	*9.3*	*-15.0*	*-16.2*	*-35.3*	*-43.9*	*-44.0*
North West Shelf Grants[(a)] ($m)	1,000	1,108	1,126	1,121	1,241	1,376
Growth [(b)] (%)	*0.5*	*10.8*	*1.6*	*-0.5*	*10.8*	*10.9*
Total General Purpose Grants	**4,453**	**4,043**	**3,584**	**2,712**	**2,135**	**1,876**
PAYMENTS FOR SPECIFIC PURPOSES						
PSPs 'to' the State [(c)] ($m)	4,179	3,777	3,938	3,941	4,090	4,499
Growth (%)	*7.0*	*-9.6*	*4.3*	*0.1*	*3.8*	*10.0*
PSPs 'through' the State ($m)	1,128	1,165	1,202	1,287	1,395	1,505
Growth (%)	*-11.9*	*3.3*	*3.1*	*7.1*	*8.4*	*7.9*
Total PSPs ($m)	**5,307**	**4,942**	**5,140**	**5,228**	**5,485**	**6,004**
TOTAL COMMONWEALTH GRANTS ($m)	**9,760**	**8,986**	**8,724**	**7,941**	**7,620**	**7,880**
Growth (%)	***4.5***	***-7.9***	***-2.9***	***-9.0***	***-4.0***	***3.4***

Source: Department of Treasury, State Budget Papers: Economic and Fiscal Outlook, 2013-14.

(a) Includes compensation for Commonwealth crude oil excise arrangements.

(b) Growth in 2015-16 reflects Woodside's announcement that the North West Shelf Project participants have approved development of the first phase of the Greater Western Flank Project, with project start-up expected in early 2016.

(c) Payments in areas of State responsibility. Does not include payments on-passed through the State (for example, to local government and private schools).

Note: Columns may not add due to rounding.

The CGC process is out-of-scope for this Inquiry and the ERA takes the forecast reduction in GST funding as a given. However, microeconomic reform could provide different means for the State's future funding needs to be met including, but not limited to:

- greater use of user charges for services and infrastructure;
- Public-Private Partnerships (**PPP's**) and similar arrangements, where large infrastructure projects (for example, new railways, roads and hospitals) are funded and operated via a partnership between Government and one or more private sector businesses; and
- more efficient use of existing infrastructure, such as encouraging off-peak period use of infrastructure including roads, public transport and electricity infrastructure.

[19] Source: AAP, *Barnett dismayed at GST share,* The West Australian, 2013.

5.3 Goods and Services Provided by Western Australian State Government Agencies and Departments

The goods and services provided by the Western Australian Government are extensive and varied. They range from the provision of essential goods and services (for instance, electricity, emergency services, hospitals, roads and water), to cultural undertakings (for example, the arts, sport and recreation), and regulatory oversight (for example, racing, gaming and liquor).

If you are seeking further information to assist in preparing your response, the Western Australian Government maintains a list of State Department and Agency websites, which are often good sources of information on specific topics.

In Western Australia, the provision of certain goods and services is undertaken by public corporations (also referred to as government trading entities), which operate on a commercial basis but are owned by the State Government, and so ultimately by the Western Australian public. These entities include Synergy, Western Power, Verve Energy, Horizon Power, and the Water Corporation. In some cases, they operate in a competitive market (for instance, Synergy competes with other providers of electricity for large business customers). However some entities operate in a non-competitive market, where they are solely responsible for the provision of goods and services in a particular sector.

Table 4 shows the 2012/13 Budget Appropriation, including funding for capital expenditure, for Departments and Agencies (not including government trading entities, which are largely self funding) receiving over $50 million in funding in 2012/13. This funding allows the Departments and Agencies to undertake the provision of goods and services discussed above.

Table 4 2013/14 Budget Estimate Consolidated Account Expenditure Estimates for Selected Western Australian Government Departments and Agencies

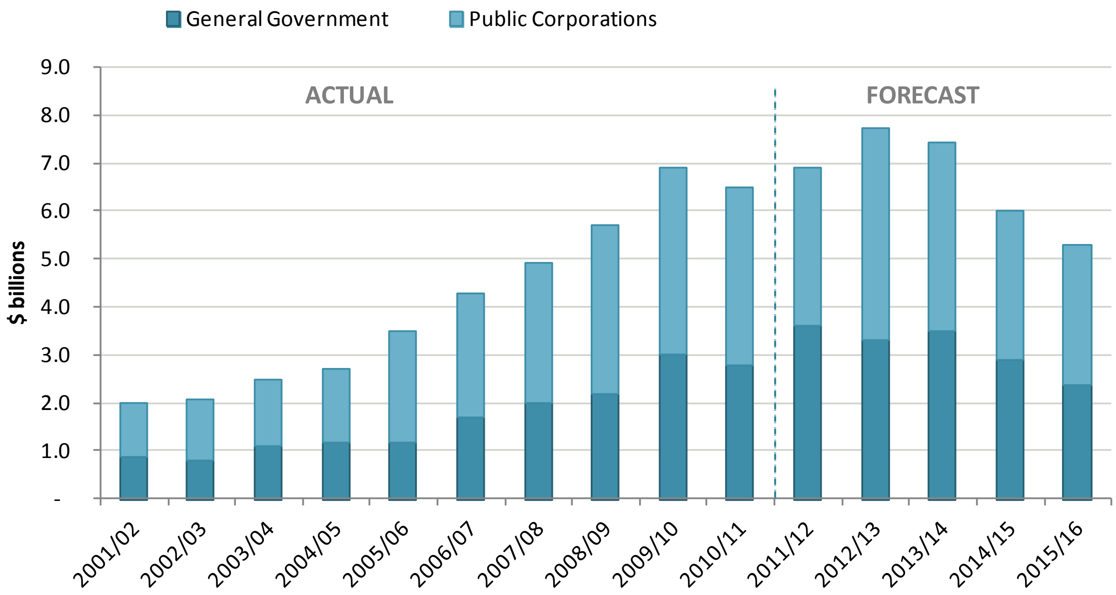
	Appropriation ($m)
Department of Health	4,508.9
Department of Education	3,889.0
Police Service (Western Australia Police)	1,225.0
Commissioner of Main Roads	1,343.3
Department of Corrective Services	762.7
Department of Finance	715.9
Disability Services Commission	638.7
Department for Child Protection and Family Support	537.3
Mental Health Commission	556.9
Department of Training and Workforce Development	465.9
Department of Education Services	419.8
Department of the Attorney General	387.8
Department of the Premier and Cabinet	235.8
Department of Transport	199.5
Department of Agriculture and Food	158.7
Department of Culture and the Arts	139.2
Housing Authority	134.8
Department of Local Government and Communities	132.6
Department of Racing, Gaming and Liquor	125.6
Public Transport Authority of Western Australia	119.0
Department of Mines and Petroleum	114.6
Department of Sport and Recreation	101.2
Department of Water	77.9
Department of Commerce	76.3
Western Australian Tourism Commission	62.0
Department of State Development	59.7

Source: Department of Treasury, Western Australian State Budget: Volume 1, 2013/14.

5.4 Infrastructure Investment

Public investment in infrastructure, including both the general government sector and public corporations (such as Western Power and the Water Corporation) has been in the region of $6 to $7 billion in each of the past three years, but is expected to fall to just over $5 billion by 2015/16, as shown in Figure 5.

Figure 5 Western Australian Historical and Forecast Infrastructure Investment ($b, real)

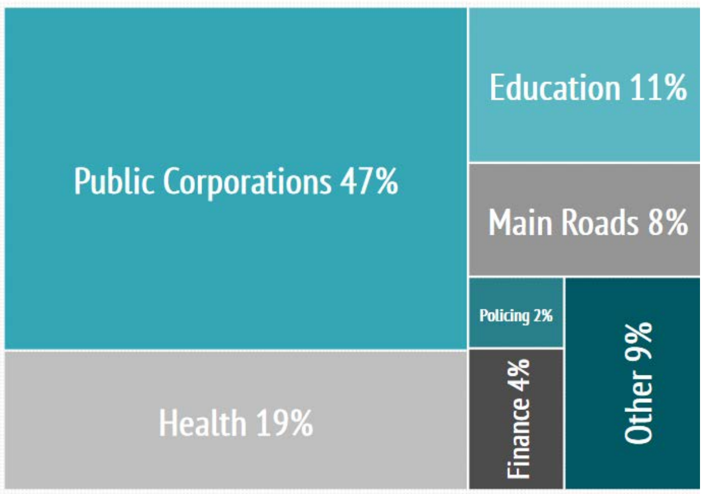


Source: Department of Treasury, Western Australian State Budget Overview, 2012/13

Figure 6 gives an indicative breakdown, on a commercial basis, of State Government infrastructure investment in 2011/12. Nearly half of all spending was allocated to public corporations, with the majority of this being invested in the energy and water sectors.

A further third of total investment has been directed towards health and education, largely relating to the construction and refurbishment of public hospitals and schools.

Figure 6 Western Australian Government Infrastructure Expenditure, 2011/12 (%)



Source: Department of Treasury, Annual Report on State Finances, 2011/12.

5.5 Future Fund

The State Government has established a Future Fund to quarantine a portion of mineral resources and associated royalty revenue over the next two decades. The purpose of the Fund is to provide funding for future economic and social infrastructure needs.

Between 2012/13 and 2016/17, the Government will transfer just over $1.3 billion in capital from the existing Royalties for Regions Fund into the Future Fund, with a minimum of one per cent of the State's annual royalty revenue to be paid into the Fund from 2016/17 onwards.

6 The Western Australian Economy

In preparing your response, you may find it useful to consider the current structure of the Western Australian economy, and the changes that have taken place in the economy in recent years.

This section is intended to provide a broad overview of these topics, and to assist you in considering the broader context in which any proposed reforms might be implemented. It includes information on topics such as forecast growth, key industries, trade and exports, population growth, regional and metropolitan issues, and planning for the future.

The Western Australian Department of Treasury also publishes current economic and revenue data on its website for the State on a regular basis. Appendix 3 provides a more extensive list of online resources that may be of use.

6.1 Overview

The Western Australian economy is driven by a strong resources sector that supplies commodities for international export – most significantly, iron ore and liquefied natural gas (**LNG**).

While the State has a long history of agricultural production and export, in recent decades growth in this sector has been eclipsed by the rapid growth seen in the resources sector, in part associated with the industrialisation of China. Other sectors such as services and construction have seen steady increases in production over the decade, in response to general economic and population growth.

The Western Australian economy has proved relatively resilient in the face of the international economic downturn since 2007. Between 2005/06 and 2011/12, Western Australia's contribution to Australia's Gross Domestic Product (**GDP**) rose from 14 per cent to over 16 per cent. Further, Western Australia was responsible for 46 per cent of the nation's exports in 2011/12, while representing just over 10 per cent of Australia's population.

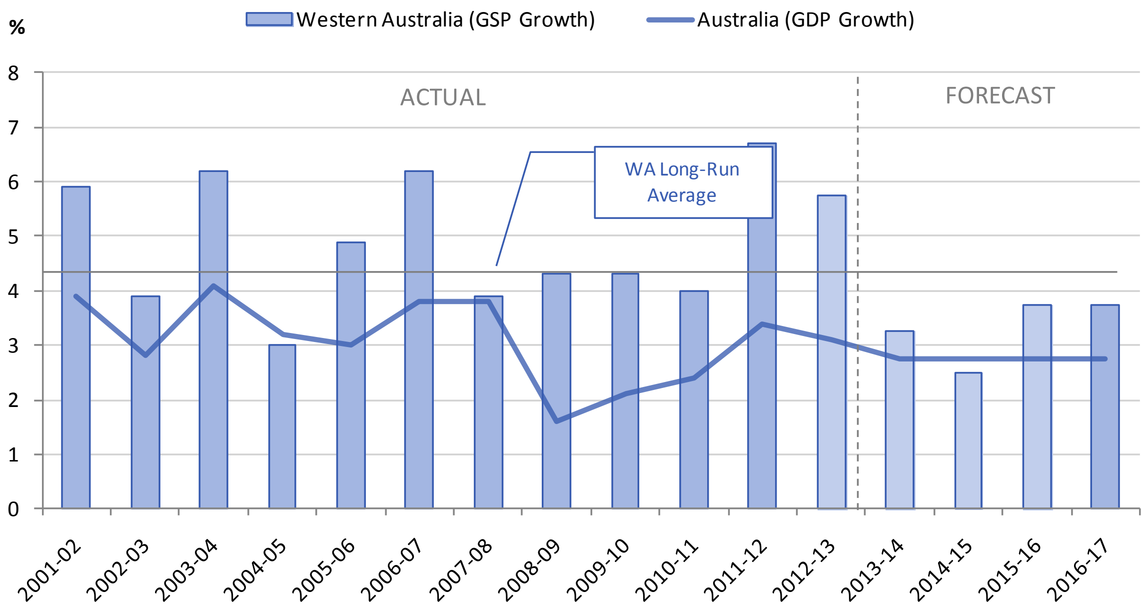
In its 2013/14 Budget, the State Government noted that the outlook for the State economy was still strong, despite forecast weakening business investment. Growth in export volumes is expected to increase in coming years, with a move away from business investment towards exports due to the completion of a number of large resources projects. This will likely occur because of a general transition from the construction phases of major projects to the production and export phases.

The Budget also noted the strong increase in Western Australia's household consumption in 2012/13 (estimated at 5.25 per cent), reflecting the State's strong population growth and labour market conditions, as well as the strong Australian dollar. Growth in Western Australia's retail trade is forecast to be stable from 2013/14 to 2014/16.

6.2 Recent and Forecast Growth

In 2011/12, Western Australia's Gross State Product (**GSP**) was $239 billion (16 per cent of Australia's GDP), a growth of 6.6 per cent in real terms upon the previous year, compared with an increase of 3.4 per cent nationally. State Treasury forecasts of GSP through to 2015/16 indicate an expectation that the State economy will on average continue to grow at a faster rate than the national average over the same period (Figure 7).

Figure 7 Real Economic Growth, Gross State Product (Western Australia) 2001/02 to 2016/17



Source: Department of Treasury, Western Australian State Budget: Volume 3, 2013/14.

Table 5 provides a more detailed overview of Western Australia's key economic indicators, as published by the State Government in its 2013/14 State Budget, including forward estimates to 2016/17.

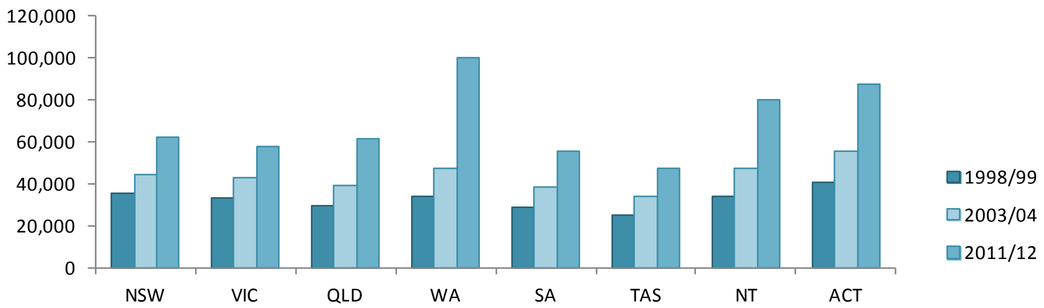
Table 5 Western Australian Key Economic Indicators (% Change)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
Demand and Output, Annual Growth						
Household Consumption	6.50	5.25	4.00	3.50	3.50	3.50
Dwelling Investment	-14.40	1.25	11.25	6.00	3.75	2.00
Business Investment	38.60	9.00	-9.00	-7.00	-5.00	-3.75
Government Consumption	5.50	2.00	4.75	4.25	4.50	4.50
Government Investment	9.40	1.00	3.00	0.50	0.75	1.50
State Final Demand (SFD)	**14.20**	**6.00**	**-0.25**	**0.50**	**1.00**	**1.25**
Merchandise Exports	4.60	9.50	6.25	4.50	7.00	6.75
Merchandise Imports	27.50	8.00	-7.75	-4.25	-1.00	0.50
Net Exports	**-3.40**	**9.75**	**12.00**	**7.25**	**9.25**	**8.50**
Gross State Product (GSP)	**6.70**	**5.75**	**3.25**	**2.50**	**3.75**	**3.75**
Labour Market, Annual Growth						
Population	3.10	3.20	2.20	2.10	2.10	2.10
Working Age Population (15-64)	2.80	2.80	1.80	1.60	1.60	1.60
Employment	3.90	3.60	1.25	1.75	1.50	1.50
Labour Market, Other Measures						
Unemployment Rate[a]	4.00	4.40	5.50	5.75	5.50	5.25
Participation Rate [a]	68.70	69.00	68.90	68.80	68.30	67.70
Prices						
Consumer Price Index (CPI)	2.20	2.30	2.50	2.50	2.50	2.50
Wage Price Index (WPI)	4.30	4.00	3.75	3.75	3.50	3.50

Source: Department of Treasury, State Budget Papers: Economic and Fiscal Outlook, 2013-14.
[a] *Data expressed in terms of the annual average during the financial year.*

In terms of GSP per capita, Western Australia has moved from being on par with most other State economies in 2003/04, to being considerably more productive per head of population in 2011/12 (Figure 8). In 2011/12 the national average GDP per capita was around $65,000, compared to GSP per capita of around $100,000 in Western Australia.

Figure 8 Gross State Product per Capita (2011/12 $)

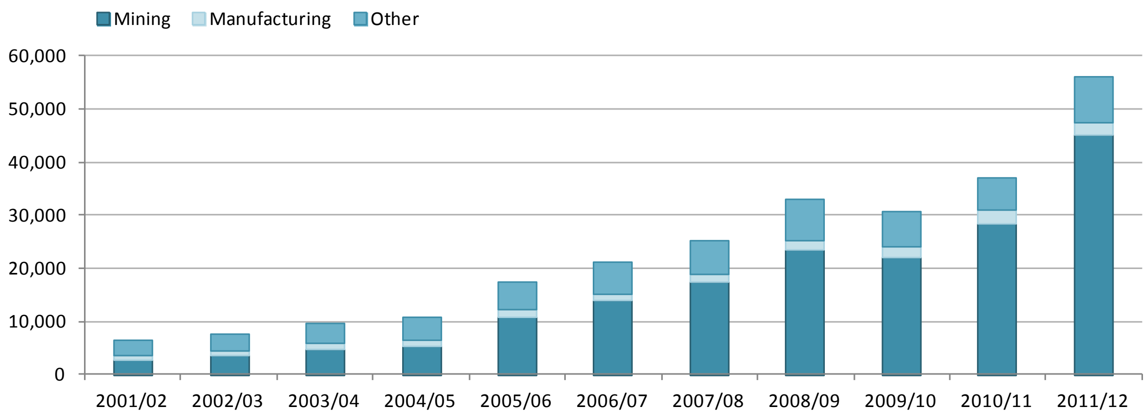


Source: Department of Treasury, State Accounts and Australian Bureau of Statistics, Catalogue 5220.0.

However, due to the level of mining and resources activity in Western Australia, the State's economy is thought to be relatively capital intensive. Hence, much of the increase in GSP per capita may be due to the increase in capital per worker. It is difficult to draw further conclusions in this area since, as discussed in Chapter 3, the information needed to understand the relationship between labour and capital is not collected on a State level.[20]

Private capital expenditure in Western Australia has seen a sharp increase over the last decade, with the majority of this increase being driven by investment in the mining sector (Figure 9). However, a number of significant iron ore and energy projects in the State have been deferred during the past year.[21]

Figure 9 Western Australian Private Capital Expenditure (2011/12 $'000)



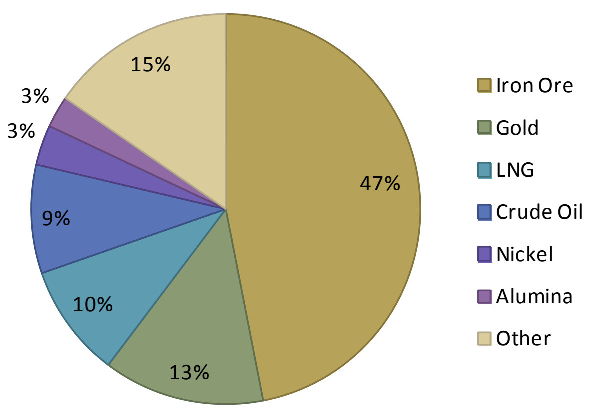
Source: Australian Bureau of Statistics, Private New Capital Expenditure and Expected Expenditure, Catalogue 5625.0.

6.3 International Trade

In 2012, over half of Western Australia's GSP was attributable to the international export of goods and services.

The State contributed 46 per cent ($114 billion) of Australia's merchandise exports in 2011/12, with around $100 billion of this relating to the mining industry, and the remainder largely to the agricultural and manufacturing sectors, as shown in Figure 10.

Figure 10 Composition of Western Australia's Export Commodities, 2012 (%)



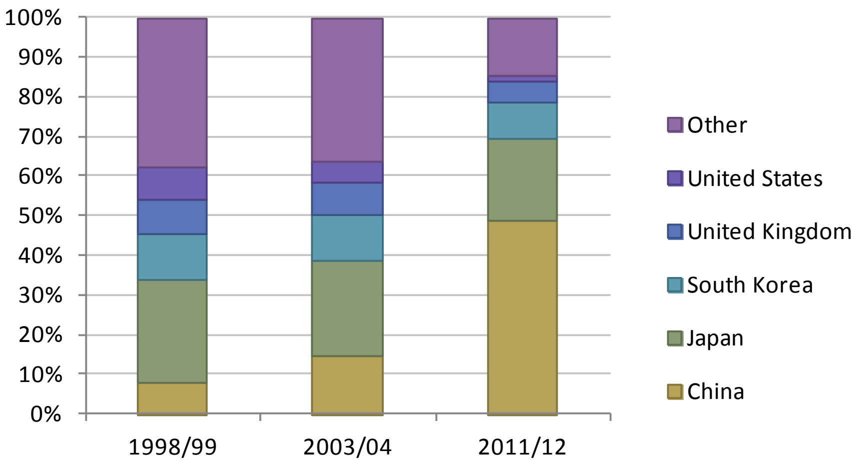
Source: Expenditure Income and Industry Components of Gross State Products, Department of Mines and Petroleum, Western Australia.

[20] The Productivity Update provides some recent research on the state of productivity. Productivity Commission, 2013, *Productivity Update: May 2013,* Australia.

[21] Bureau of Resources and Energy Economics, *Resources and Energy Major Projects*, April 2013, Australia.

As shown in Figure 11, the composition of the State's international export destinations has shifted significantly over the past decade, seeing a decrease in diversification largely due to increasing trade with China. The Chinese market accounted for less than 10 per cent of the State's exports by value in 1998/99, rising to over 45 per cent by 2011/12.

Figure 11 International Export Destinations, Western Australia (by $ value)



Source: Australian Bureau of Statistics, International Trade in Goods and Services, Catalogue 5368.0.

6.4 Major Industries

While the share of the workforce employed in most sectors of the Western Australian economy has been consistent over the past decade, the mining industry has seen a sharp increase, with the number of positions in the sector rising from around 28,000 in 1999 to 111,000 in 2013, outpacing growth in employment across the rest of the State's economy. The mining industry has grown from 3 per cent of all employment in 1999, to around 8.5 per cent in 2013, but contributed almost 40 per cent of the State's Gross Value Added (**GVA**) to the economy in 2011/12. [22]

In addition to direct mining output and employment, other sectors of the economy are also directly associated with the resources sector. For example, while no current official data exist, much of the State's manufacturing industry is made up of mineral processing and manufacturing mining equipment. Additionally, a large share of the construction industry is directly related to mining investment projects.

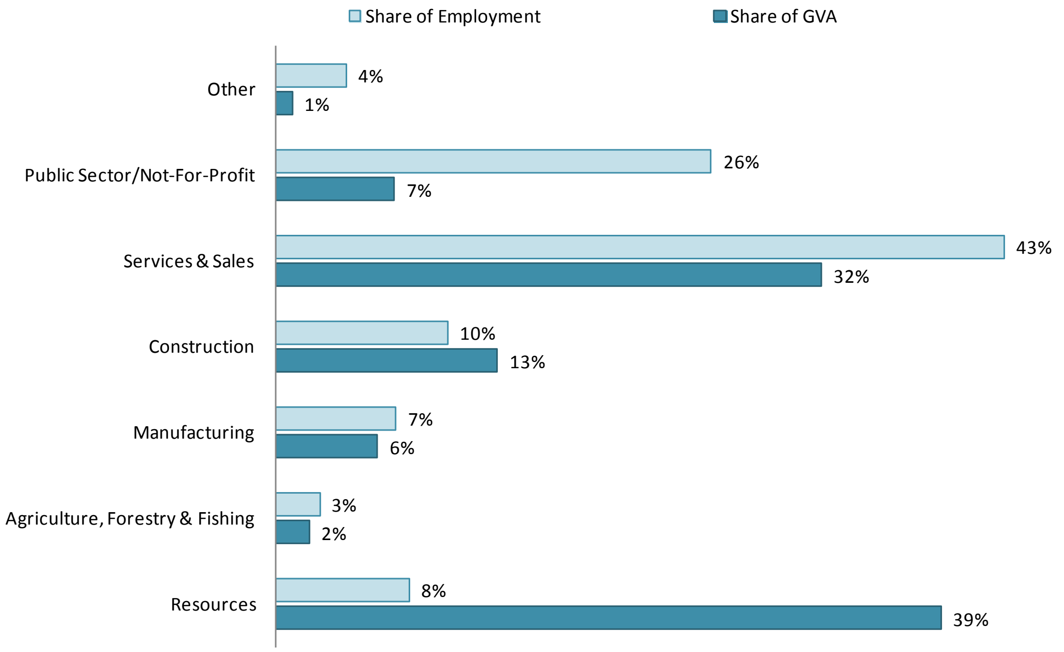
The only sector to show a decrease in employment between 1999 and 2013 was the agriculture, forestry and fishing sector, contracting from around 46,000 persons in 1999 to 40,000 in 2013.

Around a third of Western Australia's GVA is generated by the services and sales industry, which includes wholesale and retail trade, transportation and storage, and professional and technical services. The mining industry generates around a further 40 per cent and the construction sector just over 10 per cent of GVA. The public and not-for-profit sectors (7 per cent of GSP in 2011/12), agriculture, forestry and fishing (2 per cent), and manufacturing (6 per cent) sectors are responsible for the remainder of the State's GVA.

[22] The Australian Bureau of Statistics also stated that, in 2006/07, around 25 per cent of Western Australian sales and services income was attributable to mineral product manufacturing (*Manufacturing Industry, Catalogue 8221.0*). Note: GVA differs from GSP in that it excludes net indirect taxes.

Figure 12 shows each sector's contribution to employment figures against its contribution to Western Australia's GVA.

Figure 12 Economic Sectors: Share of Employment v Share of GVA – Western Australia (2011/12)

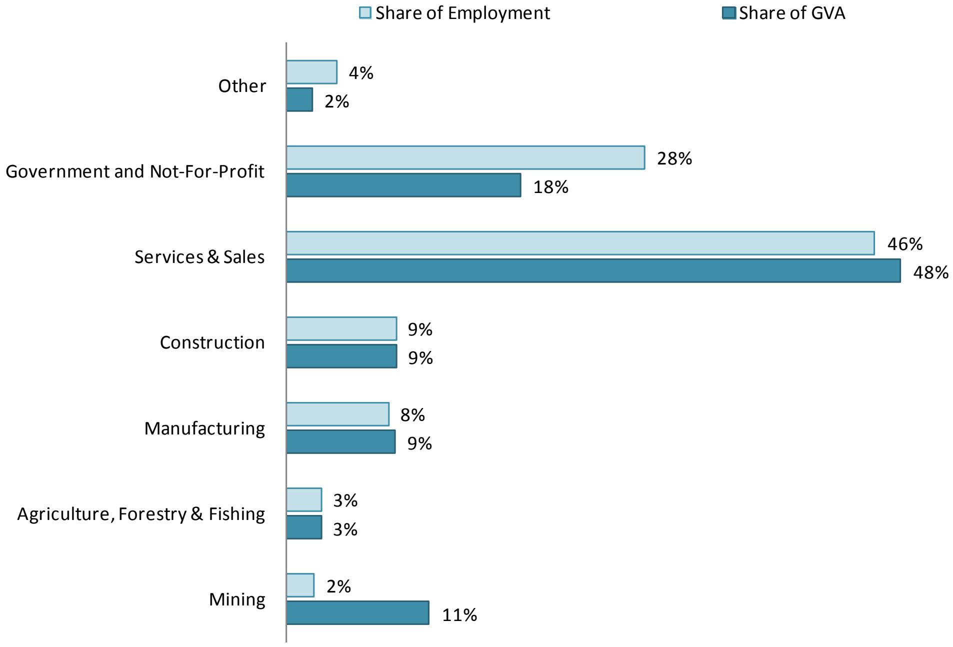


Source: Australian Bureau of Statistics, State Accounts, Catalogue 5220.0, and Labour Force, Catalogue 6291.0.55.003.

An overview of employment and GVA share by industry on a national level is shown in Figure 13. Services and sales make up a somewhat larger proportion of both employment and Federal GVA than they do Western Australian employment and GVA. Additionally, the Government and Not-for-Profit sectors make up a larger percentage of Federal than State GVA.

Most notable, however, is the difference between the percentages of employment and GVA contributed by the resources industry at a State level, as compared to those at a Federal level. The mining industry accounts for slightly over 2 per cent of total Federal employment, but over 8.5 per cent of Western Australian State employment. Further, on a national level, it contributes 11 per cent of GVA, while accounting for nearly 40 per cent in Western Australia.

Figure 13 Economic Sectors: Share of Employment v Share of GVA - Australia (2011/12)

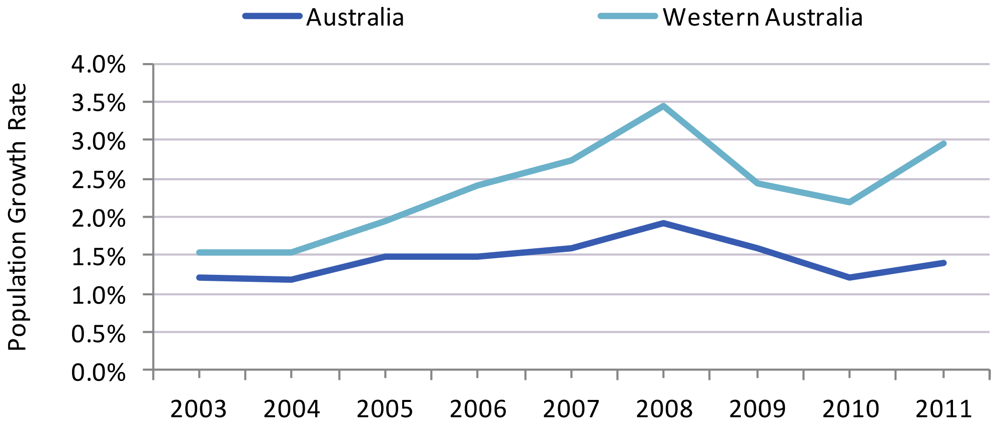


Source: Australian Bureau of Statistics, State Accounts, Catalogue 5220.0, and Labour Force, Catalogue 6291.0.55.003.

6.5 Population

Between 2000 and 2010, Western Australia's population increased at a higher rate than that of any other State. While the State has seen consistent interstate migration during the last decade, the increase in population has been primarily driven by overseas migration and natural increase.[23] Western Australia also has the highest workforce participation rate of any State in Australia. Figure 14 shows the rate of population growth over the last decade in Western Australia compared to that of Australia as a whole.

Figure 14 Population Growth in Western Australia and Australia, 2003 - 2011



Source: Australian Bureau of Statistics, Regional Population Growth Catalogue 3218.0.

[23] A natural increase in population occurs when the number of births is greater than the number of deaths during the year.

The most recent Australian Bureau of Statistics population projections for the Perth metropolitan area are given in Table 6, along with resulting population density in a scenario where the metropolitan boundaries, as currently defined by the State Government, remain unchanged.

Table 6 Population Projections for Perth

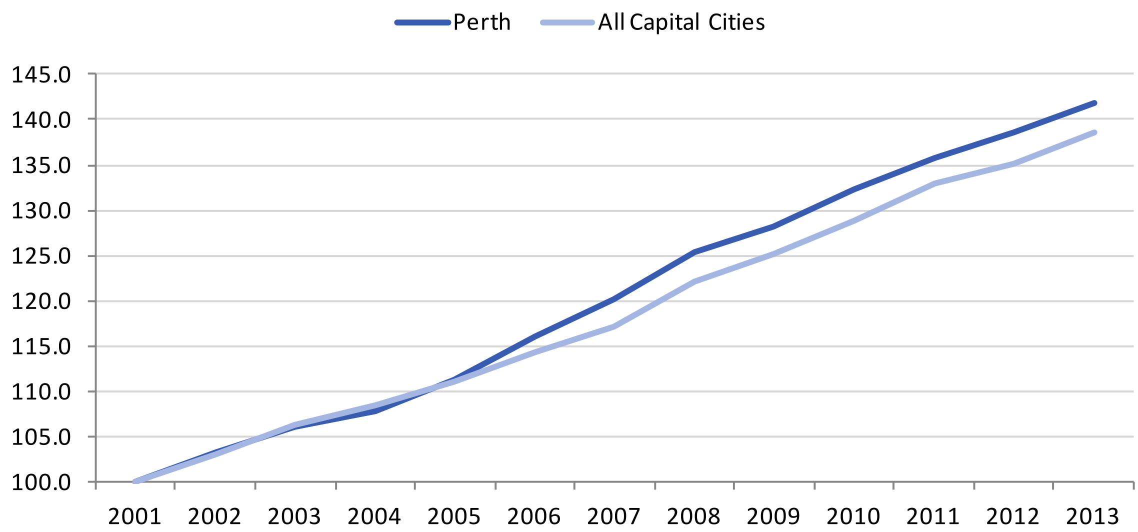
	Regional	Metropolitan	Metropolitan Density
30 June 2007	0.6 million	1.6 million	240 persons per km^2
30 June 2012	0.6 million	1.9 million	285 persons per km^2
Projected 2026	0.7 million	2.3 million	345 persons per km^2
Projected 2056	0.9 million	3.4 million	510 persons per km^2

Source: Australian Bureau of Statistics (midpoint projections, series B), Catalogue 3222.0; Economic Regulation Authority.

6.6 Living Costs in Western Australia

Since 2006, the cost of living in Perth has increased somewhat more rapidly than the average for all Australian capital cities, as indicated by the Consumer Price Index shown in Figure 15. Between the 2006 and 2012, the average CPI across Australian capital cities increased at an average annual rate of around 3 per cent, while the Perth CPI increased at a rate of around 3.2 per cent.

Figure 15 Perth and Australian Consumer Price Indices (CPI), 2001 - 2013



Source: Australian Bureau of Statistics, Consumer Price Index, Catalogue 6401.0.

However, the cost of living varies markedly across Western Australia, with areas in the north-west generally reporting a significantly higher cost of living than those closer to the metropolitan area.

The most recent Regional Price Index report, published by the Department of Regional Development and Lands (released in 2012, relating to the 2011 calendar year), compares the costs of a common basket of goods and services across a number of regional locations, to the costs of the same basket of goods and services in Perth. The northernmost regions show the greatest disparity, with the overall cost of living being 37 index points higher in the Pilbara, and 20 index points higher in the Kimberley, than in Perth.[24] This means that, for instance, the same basket of goods and services in the Pilbara costs 37 per cent more than it would in Perth.

[24] Western Australian Department of Regional Development, 2012, *Regional Price Index 2011,* Australia.

7 Questions for Interested Parties

In preparing your response, you may wish to address a number of the questions provided in the box below. The questions cover a range of issues that will be considered by the ERA in conducting this Inquiry, and are intended to assist you in developing a constructive response.

1. What sectors of the Western Australian economy are likely to benefit from the implementation of microeconomic reforms?
2. What specific reforms might improve the efficiency, productivity or flexibility of those sectors, and why?
3. What economic and social benefits might those specific reforms have for individuals, businesses and/or the State?
4. What economic and social costs might those specific reforms have for individuals, businesses and/or the State?
5. Are you aware of any additional information that may assist the ERA in assessing the efficiency of the sector in question, or the costs and benefits of the proposed reforms?
6. Are you aware of any examples of other jurisdictions (either in Australia or overseas) where similar reforms have been implemented? How effective were the reforms in those jurisdictions?
7. Is the ERA's proposed use of the Compensation Principle appropriate or is there a more appropriate way to evaluate the net benefit of reforms?
8. Is the ERA's framework for prioritising reform opportunities (that is, likely benefit versus ease of implementation) appropriate?
9. Are there alternative frameworks that would provide a superior assessment?
10. What do you consider to be the most appropriate method for assessing the economic value of a given reform? What are the significant advantages and disadvantages of this approach?
11. Can you provide any additional information that may assist the ERA in understanding microeconomic reform opportunities in Western Australia?

APPENDICES

Appendix 1 Terms of Reference

INQUIRY INTO MICROECONOMIC REFORM IN WESTERN AUSTRALIA

TERMS OF REFERENCE

I, TROY RAYMOND BUSWELL, in my capacity as Treasurer and pursuant to section 38(1)(a) of the *Economic Regulation Authority Act 2003* request that the Economic Regulation Authority (ERA) undertake an inquiry every four years into the microeconomic reform priorities for Western Australia.

The objective of the inquiry is to develop the most advantageous package of microeconomic reform measures that the Western Australian Government could implement to improve the efficiency and performance of the Western Australian economy.

The inquiry should identify areas of reform that have the potential to achieve the following outcomes:

- improved productivity and flexibility of the Western Australian economy;
- increased choice for consumers and business that leads to net economic benefits to Western Australia;
- increased opportunities for Western Australian businesses to effectively compete for national/international market share; and
- the removal or streamlining of unnecessary regulation.

In developing its recommendations, the ERA must give consideration, but not be limited, to the following:

- assess the current level of efficiency of Western Australia's economy, including by comparison with other relevant national and international economies;
- identify those areas in the economy where reform could enhance their contribution to the overall Western Australian economy;
- identify options for improving economic efficiency of the key areas identified above;
- prioritise key areas of reform based upon the potential impact on overall economic efficiency and future growth; and
- recommend a small number of specific key reforms or sectors that require further investigation by the ERA and policy development by the Government.

For the first inquiry, the ERA will publish an issues paper as soon as possible after receiving these terms of reference. During the course of the inquiry, the ERA will publish a draft report and then provide a final report to the Treasurer by 30 June 2014.

For subsequent inquiries, the ERA will publish an issues paper not later than nine months prior to the election of a new State Government, publish a draft report not later than three months after the election, and provide a final report to the Treasurer as soon as practicable thereafter.

Appendix 2 Past Key Reforms Undertaken in Australia

Appendix 2 provides a more detailed list of past key reforms implemented in Australia, to supplement the examples given in the body of the Issues Paper. This list aims to provide you with examples of various types of reforms introduced by the Commonwealth Government, but is not an exhaustive list of reforms undertaken.

Industry	Reform
Education	Free tertiary education (1970s): The Federal Government abolished university fees in 1973, increasing the university participation rate. In 1974, the Government also assumed full responsibility for funding higher education in Australia and established the Commonwealth Tertiary Education Commission to take on an advisory role and allocate Government funding.
	Higher Education Contribution Scheme (1989): The scheme required all university students to pay a $1,800 fee, with the balance of university education costs being met by the Federal Government. This payment could be deferred, and repaid via the taxation system when the student's income reached a certain threshold. During the 1990's, HECS was restructured, with the creation of a three-tier system where fees were charged in line with the perceived value of the course being undertaken, and HECS fees were increased by around 40 per cent.
	Creation of full fee paying places for university undergraduates (1998).
	Deregulation of university fees (2005): Universities permitted to increase fees by a maximum of 25 per cent.
	State Learning Entitlement (2007): University students limited to a maximum of 7 years' full time study at Federally subsidised rates, requiring students to transfer to a full fee paying model thereafter. This was later removed in 2012.
Health	Introduction of Medibank (1975): Prior to the implementation of Medibank, a substantial percentage of low-income Australians were without health insurance. Medibank established universal health care by providing health insurance to all Australians, funded from general revenue.
	Medibank Mark II (1976): This programme resulted in a substantial overhaul of the original Medicare system, and introduced a 2.5 per cent levy on income to fund the Medibank system, providing taxpayers with an option of purchasing private health insurance as an alternative to paying the levy. It also reduced rebates to doctors and hospitals.
	Medibank Private (1976): The Medibank Private bill allowed the Health Insurance Commission to enter the private health insurance market.
	Medicare (1984): The replacement of Medibank Mark II with Medicare was largely a return to the original Medibank model implemented in 1975. Medicare is partly funded by a 1.5 per cent levy, with exemptions for low-income earners. Presently, high-income earners pay an additional levy if they do not hold private health insurance, known as the Medicare Levy Surcharge, aimed at encouraging high-income Australians to procure health insurance from private providers.
	Privatisation of services in public hospitals (1990's): Selected services in public hospitals were outsourced to private sector providers.

Health	Commonwealth-State Disability Agreement (1992, 1997, 2002, 2009): The first agreement undertook the replacement of existing *ad hoc* arrangements with an integrated, national scheme for the provision of disability services, with the second agreement developing a more extensive framework and establishing funding targets. The third required a growth commitment from State and Territory Governments signing up to the agreement, and established a stronger accountability framework for disability services provision. The fourth established primary outcomes for people with a disability, along with key performance indicators to assess the achievement of these outcomes.
	Aged care reforms (1997): The Aged Care Standards and Accreditation Agency Ltd was established as an independent company and appointed as the accreditation body under newly introduced aged care legislation. The Agency carries out supervision of accredited aged care homes, and assists the homes in undertaking a process of continuous improvement.
	New measures were introduced to expedite the evaluation of low risk products and new substances (1997-98), making it easier for Australians to access improvements in medical treatment on a more timely basis.
Tariffs and Quotas	Tariff cuts (1973): All tariffs were cut by 25 per cent, allowing Australian businesses to more cost-effectively import products subject to tariffs such as motor vehicles and textiles. Further cuts followed in 1988 and 1991, seeing the commencement of a progressive phase-out of tariffs in Australia.
	The 1980's saw the removal of import quotas that had previously restricted the volumes of motor vehicles, textiles, clothing and footwear imported into Australia.
	Adoption of the international commitments commencing in 1995, resulting in all remaining quotas on agricultural products being replaced by tariffs.
	Between 1990 and 1998, the average tariff in the agricultural sector was reduced from around 0.9 per cent to 0.3 per cent, in the mining sector from 1.1 per cent to 0.6 per cent, and in the manufacturing sector from 11.1 per cent to 6.0 per cent. Tariff reductions continued across these sectors throughout the 2000's.
Financial Standards and Regulation	Foreign Investment Review Board (**FIRB**) (1976): FIRB was established to advise the Government on foreign investment policy, and on the administration of legislation relating to foreign acquisitions and takeovers of Australian companies.
	Floating of the Australia dollar (1983): Previously, the Australian dollar had been 'pegged' to the US dollar, at a rate of A$1 to US$1.12. The reforms allowed the exchange rate of the Australian dollar to move independently against other currencies.
	Accounting Standards Review Board (1984): The Board was established to review the standards produced by the accounting profession in Australia, and to give these the force of Company Law where approved. The Board was re-established under the Australian Securities Commission Act in 1989 and was renamed the Australian Accounting Standards Board (**AASB**). The Financial Reporting Council (**FRC**) was introduced to provide independent oversight of the Board. The board merged with the Public Sector Accounting Standards Board in 2000.
	International Financial Reporting Standards (**IRFS**) (2002): The FRC directed the AASB to adopt International Financial Reporting Standards (IFRS), to facilitate the introduction of globally consistent financial reporting, with the new standards being introduced in 2005. The FRC also directed the AASB to harmonise public sector accounting standards with Generally Accepted Accounting Principles (**GAAP**) in 2003.

Financial Standards and Regulation	Australian Securities and Investments Commission (**ASIC**) and the Australian Prudential Regulation Authority (**APRA**) (1997-98): In line with the recommendations of a 1996 inquiry into financial regulation in Australia, ASIC and APRA were established to provide regulatory oversight. ASIC became the regulator for investment banks and finance companies, and is responsible for market integrity and consumer protection. APRA is responsible for prudential regulation, including the oversight and licensing of insurance companies and superannuation funds.
	Reforms to cheque settlement and payment orders in 1998 allowed the majority of such payments to be settled in real-time, for the first time, rather than deferred.
	Australian Financial Services Licence (**AFSL**) (2001): The Corporations Act adopted in 2001 established a uniform approach to the regulation of financial services providers, enforcing compliance with licensing and disclosure requirements. Financial services providers impacted by the new regulations included financial advisors, stockbrokers, creators of financial markets, and operators of managed investment schemes.
	In 2008, major cuts were made to the registration fees required to establish a new business.
Taxation	Capital Gains Tax (**CGT**) (1985): Legislation passed requiring that, when a capital asset was sold, any gain on sale was to be treated as taxable income for that year. A number of exemptions were allowed, including any gains made on the sale of the owner's primary residence.
	Dividend imputation system (1987): The system removed an existing mechanism that resulted in double taxation of dividends received. Further regulations relating to exemptions and refunds were introduced in the late 1990's and early 2000's.
	Goods and Services Tax (**GST**) (2000): The establishment of the GST, a value added tax on most goods and services transactions, replaced the previous wholesale tax system, and included the phase-out of a number of State and Territory Government taxes.
Manufacturing	Motor Industry Development Plan (1985): The Plan aimed to improve the efficiency of the motor vehicle industry in Australia, allowing import tariffs on Personal Motor Vehicles (**PMV's**) to be gradually reduced, thereby increasing competition in the motor vehicle market and encouraging a competitive export industry. It enabled the introduction of 'badge engineered' vehicles, where the same vehicle could be sold by several companies under different names. The PMV industry has also been subject to various forms of assistance from the Federal Government since the 1980's, in an attempt to invigorate the export industry and to allow for the phased reduction of tariffs.
Transportation	Coastal Shipping: Restructuring took place in the 1980's, with partial deregulation of the industry and a new licensing scheme. Further reforms were implemented in 2012, with the aim of strengthening the Australian shipping agency, and included an overhaul of the licensing regime, changes to reporting requirements for the new classes of licence, and changes to civil penalties and taxation arrangements, as well as the establishment of an Australian International Shipping Register.
	Federal Interstate Registration Scheme (**FIRS**) (1987): The Scheme provided an alternative to State-based registration of heavy vehicles, providing uniform charges and operating conditions for heavy vehicles engaged in the interstate carriage of passengers or goods.

Transportation	National highways: In 1974, the Federal Government assumed responsibility for the funding of key national road links in Australia. The Federal Government passed updated legislation relating to the funding and maintenance of the national highway system in 1988 and 2005, and later brought national highways under the jurisdiction of the Nation Building Program.
	Domestic airline reform in the 1990's led to the removal of the Two Airlines Policy that had been in place since 1952. Under the Policy, only two airlines were permitted to operate flights between a State capital city and major regional city airports, with the two airlines being the privately owned Ansett Airlines, and the Government-owned Trans Australia airlines for much of the period in which the Policy was in place. This allowed for competition in the aviation sector, with the entry of new airlines.
Telecommunications	Full competition: Australia's telecommunications market was opened to full competition on 1997, with the passing of the Telecommunications Act. The Act removed all restrictions on the number of licensed carriers operating in the market, and established a single national phone numbering scheme.
	Telstra: The Government owned telecommunications provider was privatised in three phases in 1997, 1999, and 2006 respectively.
	National Broadband Network (**NBN**): The Government established the NBN Co, a Government corporation, in 2009 to commence the design and roll-out of a national broadband internet scheme, intended to replace the copper network currently owned by Telstra, and to provide broadband internet to 93 per cent of premises by 2021.
Water	Council of Australian Governments (**COAG**) Water Reform Framework (1994): The Framework was established to improve co-operation between State and Federal Governments on issues relating to water supply, including governance, pricing, demand, infrastructure, and environmental degradation. This was followed by the drafting of the National Water Initiative NWI in 2004, which required Governments to commit to specific improvements to water management practices.
Labour Markets	Prices and Incomes Accord (1983-1991): The series of accords established an agreement between the Australian Council of Trade Unions (**ACTU**) and the Commonwealth Government. The agreement covered a wide range of areas, and resulted in the establishment of a National Occupational Health and Safety Commission, assistance and tax cuts to low-income families, increases in pensions and unemployment benefits, the introduction of 3 per cent award superannuation, and the introduction of tax avoidance measures.
	Industrial Relations Reform Act (1993): The Act introduced a set of minimum entitlements in the workplace, based on a principle of equal remuneration for equal work, and establishing unpaid parental leave, unfair dismissal laws, and minimum wages.
	Workplace relations legislation: The Industrial Relations Act that had been in force since 1988 was replaced with the Workplace Relations Act in 1996, providing for the continuation of the Federal award system which provides a minimum set of conditions for employers. The Act also restricted the matters that couple be determined by the Australian Industrial Relations Commission (**AIRC**) to a set of 20 'allowable award matters', and resulted in the introduction of Australian Workplace Agreements (overriding collective agreements), the expansion of enterprise bargaining agreements, and the imposition of restrictions on union activity. It was subsequently amended by WorkChoices legislation in 2005, which changed dismissal protections laws, and processes for agreement certification, but was substantially rolled back in 2008 when the Government abolished Australian Workplace Agreements.

Labour Markets	Job Network (1998): Job Network was established in 1998, following the dissolution of the Commonwealth Employment Service, with its primary function being to assist the unemployed in obtaining work. It was renamed Job Services Australia in 2009, and provides training in job-seeking skills, resume assistance, the Employment Pathway Plan to assist job seekers experiencing disadvantage, and the provision of work experience opportunities.
Agriculture	Marginal Dairy Farms Agreement Act (1970): The Act made available up to $25 million over a four year period for the Marginal Dairy Farms Reconstruction Scheme, which sought to assist low-income dairy farmers who wished to leave the industry while receiving a fair price for their land and improvements, and to make these available to other farmers wishing to build up their properties to establish a viable business.
	Rural Reconstruction Scheme (1971): The Scheme provided assistance to farmers that included debt reconstruction (the rearrangement of debts, carry-on finance and concessional loans), farm build-up (assistance in amalgamating properties determined to be too small to be viable, with adjoining holdings, or in acquiring additional land), and rehabilitation (the provisions of loans of up to $1,000 to those obliged to leave the industry to alleviate conditions of personal hardship).
	Dairy industry: The Kerin Plan (1986) provided 'domestic market support' to the dairy industry, with measures to support domestic prices, restrict imports, subsidise exports, and restrict the production of substitutes. These measures were gradually phased out over the 1990's, culminating in the full deregulation of the industry in 2000. The Dairy Adjustment Authority was established in 2001 to assist farmers in managing the impacts of deregulation, with the Supplementary Dairy Assistance Scheme distributing $111 million to affected farmers over an eight year period.
	Wheat industry: Production of wheat was fully deregulated in 1989, and a compulsory levy on the value of wheat is instituted for the purpose of releasing the Government from directly guaranteeing the Australian Wheat Board's (**AWB**) loans. The AWB retained its monopoly on the export industry. In 1999, the AWB ceased operating as a Government controlled authority, and became AWB Limited, a corporation owned and operated by growers, with all government financial assistance ceasing at this point. The Wheat Export Authority (**WEA**) was established at this time to monitor AWB's performance, exercise control over exports, manage the issuance of export consents, and manage bulk wheat export licensing. After a series of inquiries and reviews, additional auditing powers were given to the WEA (replaced by the Wheat Exports Commission) in 2007, and the deregulation of wheat exports commenced, being completed in 2008.
	Rural Adjustment Schemes: A series of Rural Adjustment Schemes were implemented by the Federal Government between 1977 and 1992. These provided a variety of assistance measures including concessional loans and grants to farmers, advances for essential expenses during market downturns, rehabilitation grants and household support for farmers assessed as non-viable, loans and grants for training and professional advice, and interest subsidies.
Energy and Resources	National Electricity Market (**NEM**) (1998): The NEM was established in 1998, providing an interconnected power system servicing New South Wales, Victoria, Queensland, South Australia, Tasmania, and the Australian Capital Territory. The Australian Energy Market Operator (**AEMO**) was formed to manage the operation and long-term planning aspects of the interconnected power system, and the Australian Energy Regulator (**AER**) to provide regulation and compliance enforcement.

Energy and Resources	National Gas Access Regime (1997 onwards): The Regimes were developed jointly with the State and Territory Governments to establish the rights and obligations of gas pipeline operators, and to facilitate access of third parties to gas transmission and distribution pipelines, to encourage competition in gas markets.
	Minerals Resource Rent Tax (**MRRT**) (2012): The MRRT introduced a 30 per cent tax to be paid by on profits generated iron ore and coal mining firms, where the firm's annual profit exceeded $75 million.
	Regional Forestry Agreements (**RFA's**) (1997 to 2001): 20-year plans for the conservation and sustainable management of Australian native forests were signed over the period from 1997 to 2001, between the Federal Government, and the Governments of Western Australia, Victoria, Tasmania, and New South Wales. The RFA's provide a framework for managing the requirements of forest-based industries, forest-based communities, and conservation.
	Mandatory Renewable Energy Target Schemes (2001 and 2011): The schemes established annual renewable energy targets (later split into separate schemes relating to small scale and large scale technologies) to encourage the development of renewable energy in Australia. The schemes require electricity retailers to purchase a specific proportion of the electricity that they on-sell from renewable sources.
	Kyoto Protocol (2007): The Federal Government ratified the 1997 Kyoto Protocol, committing Australia to binding targets for Greenhouse Gas emissions reductions.
	National Greenhouse and Energy Reporting Act (2007): The Act established the National Greenhouse Emissions Reporting Scheme (**NGERS**), requiring corporations meeting a specified emissions threshold to register and provided independently audited reports on Greenhouse Gas emissions each year.
	Clean Energy Act (2011): The Act established a carbon pricing mechanism in Australia, and provided for industry assistance programs, the Jobs and Competitiveness Program, and the coal-fired electricity generation assistance package.

Appendix 3 Further Resources

In addition to the information provided in this Issues Paper, the following resources may also assist you in preparing your response:

Online Resources:
Australian Bureau of Statistics
List of All State Government Departments & Agencies

Department of Agriculture and Food
Department of Commerce
Department of Education Services
Department of Environmental Regulation
Department of Finance
Department of Health
Department of Housing
Department of Local Government and Communities
Department of Mines and Petroleum
Department of Regional Development
Department of State Development
Department of Training and Workforce Development
Department of Transport
Department of Treasury
Department of Water
Landgate
Planning Western Australia
Public Utilities Office
State Library of Western Australia

Appendix 4 Glossary

ACTU	Australian Council of Trade Unions
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFSL	Australian Financial Services License
AIRC	Australian Industrial Relations Commission
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Council
AWB	Australian Wheat Board
CBA	Cost Benefit Analysis
CGC	Commonwealth Grants Commission
CGE	Computable General Equilibrium
CGT	Capital Gains Tax
COAG	Council of Australian Governments
ERA	Economic Regulation Authority
GST	Goods and Services Tax
FIRB	Foreign Investment Review Board
FIRS	Federal Interstate Registration Scheme
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GSP	Gross State Product
IFRS	International Financial Reporting Standards
LNG	Liquid Natural Gas
NBN	National Broadband Network
NEM	National Electricity Market
NGERS	National Greenhouse and Energy Reporting Scheme
PMV	Personal Motor Vehicle
PPP	Public Private Partnership
PSP	Payments for Specific Purposes
RFA	Regional Forestry Agreement
SFD	State Final Demand
TFP	Total Factor Productivity
WEA	Wheat Export Authority