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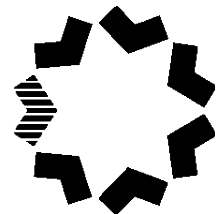
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CENTRE FOR
INTERNATIONAL
ECONOMICS



National
Competition
Council

Guidelines for NCP legislation reviews

Prepared for the National Competition Council

*Centre for International Economics
Canberra & Sydney*

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Foreword

Foreword

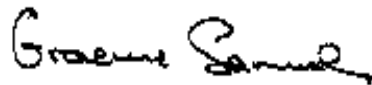
Australia's governments use regulation to achieve many valuable social and economic objectives. However, unless the objectives of regulation are clearly identified and achieved in the most effective manner, business competitiveness and the productivity of the economy may be impaired and Australia's living standards diminished.

Under the National Competition Policy (NCP), all governments established a legislation review and reform program, which they are conducting over some four years to the end of the year 2000. This is a significant program, with governments undertaking to examine and, where appropriate, reform around 1800 pieces of legislation restricting competition. The guiding reform principle is that restrictions be removed unless they can be shown to confer a net benefit on Australia and unless restricting competition is the only way to achieve the objective of the legislation. Governments must show that all new and amended legislation restricting competition also meets this principle.

To a large extent, the success of the legislation review and reform program depends on robust processes. Good quality reviews and reports require comprehensive terms of reference that reflect competition principles, appropriate review mechanisms addressing in full the guiding NCP principles, appropriate consultation with the community and review recommendations consistent with the evidence. Implementation of review recommendations is also important. Under the NCP, governments have undertaken to apply recommended reforms or, if they do not, to show why non-implementation benefits the community.

Australia is just over half way through its legislation review program. The experience to date has raised a number of questions. For example, while all governments have guidelines for those responsible for conducting the program, practitioners continue to explore 'best practice' review processes and the experience of others in conducting reviews and translating recommendations into policy. People whose activities are affected by legislation being reviewed want to know how governments should conduct reviews, how they can most effectively participate in the process, and how best to identify restrictions and assess their costs and benefits.

To give some practical help with these questions, the NCC asked the Centre for International Economics (CIE) to set out as clearly as possible a framework covering the NCP legislation review and reform process, including implementation of recommendations. The CIE's work builds on governments' existing legislation review guidelines and the experience to date with the legislation review program. The NCC strongly endorses the advice of the CIE.



Graeme Samuel
NCC President

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Background and purpose

Background and purpose

Many Australians interested in National Competition Policy (NCP) reviews ask how reviews of restrictive legislation should be conducted and what constitutes a good review. Given the aims, presumptions, expected benefits and problems of NCP legislative reviews, there are several general requirements for all reviews. To help identify general requirements and to help answer the questions above, the National Competition Council has contracted the Centre for International Economics (CIE) to develop a general comprehensive framework for conducting NCP reviews.

This general framework is designed to:

- identify and clarify the important steps for scheduled legislation reviews under the Competition Principles Agreement (CPA);
- indicate the important steps and conduct of the legislative review process (clause 5 of the CPA) required to achieve satisfactory progress with implementation of NCP and related reforms and to do so in the specified time under the Agreement to Implement National Competition Policy and Related Reforms;
- specify guidelines about how to effectively conduct each important step; and
- articulate the general elements of a good review in a nontechnical way so that guidelines can serve as a checklist to evaluate each review.

The framework covers:

- establishing a review;
- undertaking a review; and
- implementing the review's recommendations into policy.

It builds on existing guidelines and experience gained so far in conducting NCP reviews.

Background to the National Competition Policy

- In April 1995, all Australian governments signed three agreements committing them to Australia's National Competition Policy:
 - The Competition Principles Agreement;
 - The Conduct Code Agreement; and
 - The Agreement to Implement National Competition Policy and Related Reforms.

- The agreements commit all Australian governments to a comprehensive process of review and, where appropriate, reform by the end of the year 2000 of all laws (legislation, regulations, rules, proclamations and ordinances) which restrict competition.

- The National Competition Council (NCC) has been set up to advise the Federal Treasurer on progress by states and territories toward fulfilling NCP agreements and to provide guidance on reviews.

- National Competition Policy makes provision for substantial financial transfers from the Commonwealth to states and territories conditional on the states making satisfactory progress in implementing NCP and related reforms.

- If a state has not undertaken the required action within the specified time the Commonwealth will retain its share of Commonwealth funds.

Expected gains from regulatory reviews

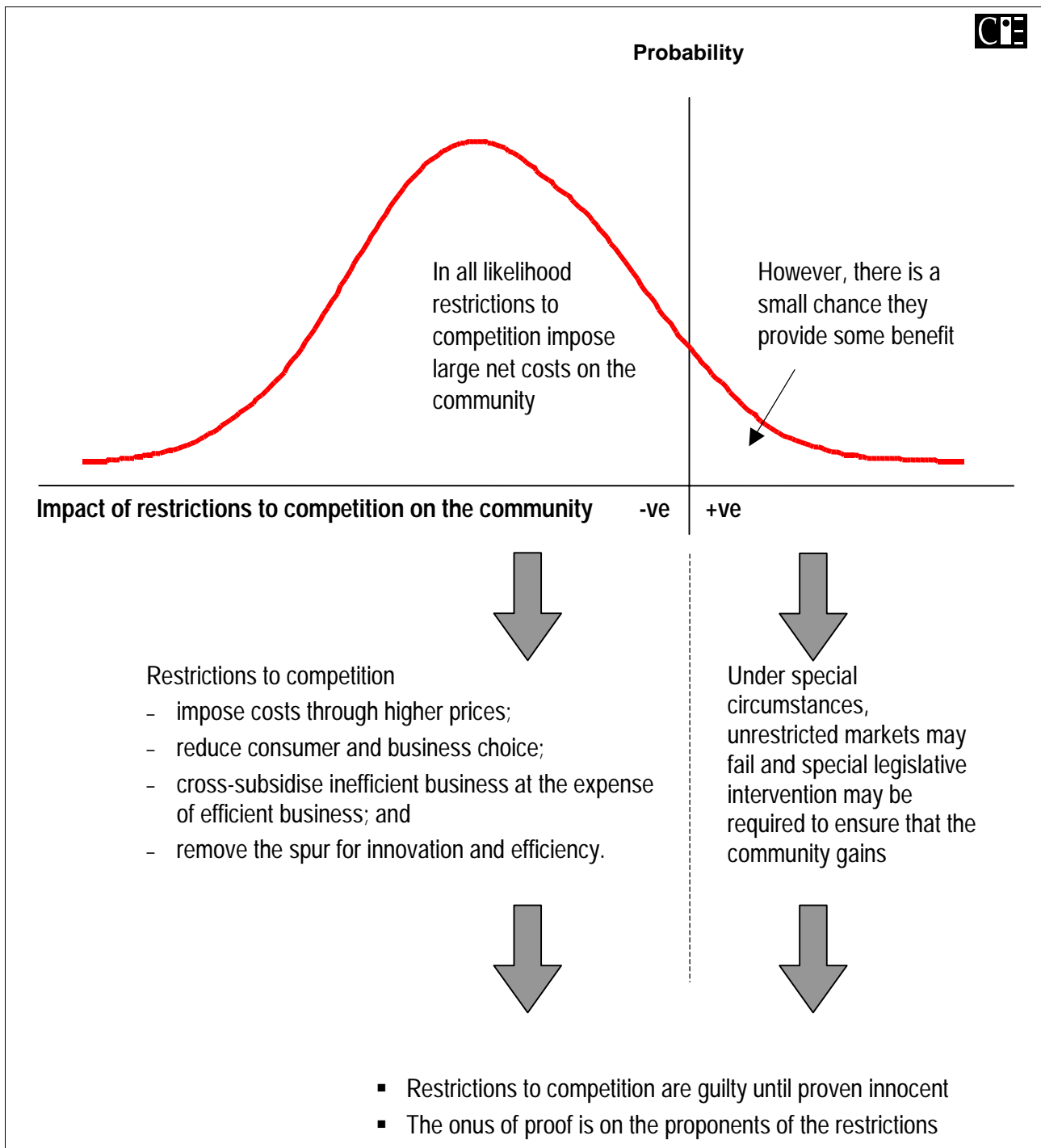
‘Many of the benefits of regulatory reviews come, not from the precision of calculations, but from the action of analysing — questioning, understanding real world impacts and exploring assumptions.’ (OECD 1995, p. 11, quoted in Industry Commission 1996, *Regulation and its Review 1995-96*, Canberra)

- The aims of NCP legislation reviews are:
 - to remove or improve regulatory restrictions to competition which harbour inefficiencies and unnecessary costs to the economy; and
 - to ensure that competitive pressures in the economy are as strong as possible to provide a spur to innovation, lower costs and higher incomes for Australians.

- There are four main gains expected from NCP reviews.
 - The competition dividend — the benefits from lower prices, more innovation and efficiency. One US evaluation found that 15 public benefit tests of regulation resulted in regulatory changes worth \$10 billion. But the tests cost only \$10 million to conduct — a payoff of 1000:1 (Industry Commission 1996 — see above).
 - Transparency of decisions and consultation to help affected groups accept change.
 - Cultural change among regulators by giving them a new mindset or framework within which to think about the costs of their decisions and how to achieve more efficient outcomes.
 - Provides a framework to systematically test the relevance of legislative objectives to the contemporary environment.
 - Provides a framework for assessing the relevance and value of new legislation. All new legislation that restricts competition must include a regulatory impact statement that is consistent with the principles of NCP.
 - Provides a requirement that any legislation that continues to restrict competition will be systematically reviewed at least once every ten years.
 - Substantial payments to states and territories from the Federal Government for successfully undertaking and implementing NCP reviews.

The presumption of NCP legislation reviews

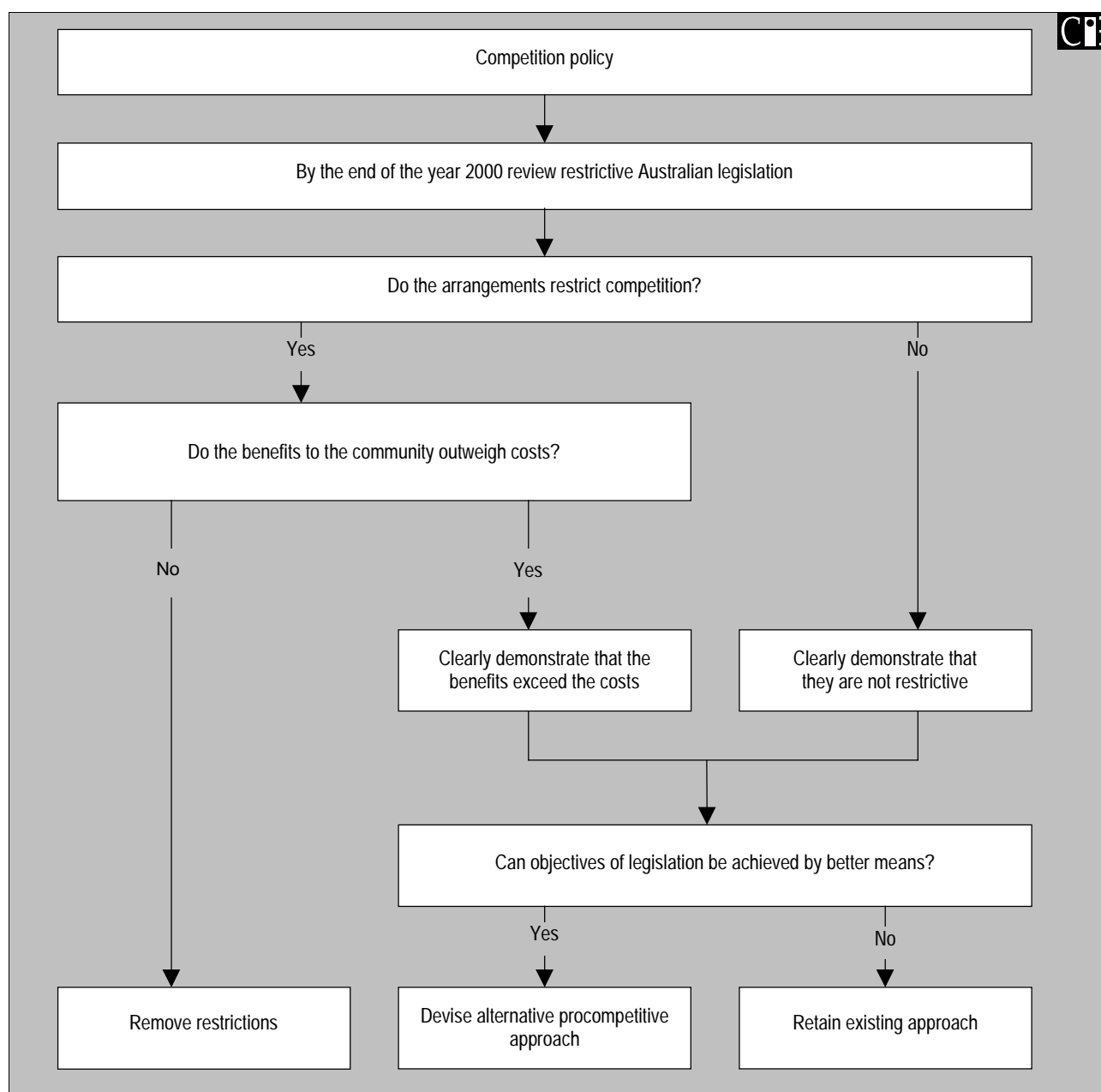
Although restrictions to competition usually impose costs on the community, it is acknowledged that under special circumstances they may provide benefits. Nonetheless, as shown below, the NCP presumption is that restrictions will be removed unless proven to be beneficial.



The guiding principle of NCP regulatory reviews

The main guiding principle of NCP reviews is that legislation should not restrict competition unless it can be demonstrated that:

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



Types of regulations which restrict competition

Examples of types of restrictions may include the following.

- Legislatively created monopolies to provide or operate infrastructure, marketing schemes (particularly in agriculture) or special government-backed initiatives.
- Licensing schemes which restrict entry to particular businesses such as taxi licences and airline agreements.
- Regulations which restrict entry to particular professions such as the medical profession.
- Quota restrictions to preserve natural resources.
- Regulations which specify strict technical standards for products or services.
- Administratively determined pricing arrangements for nominated goods and services.

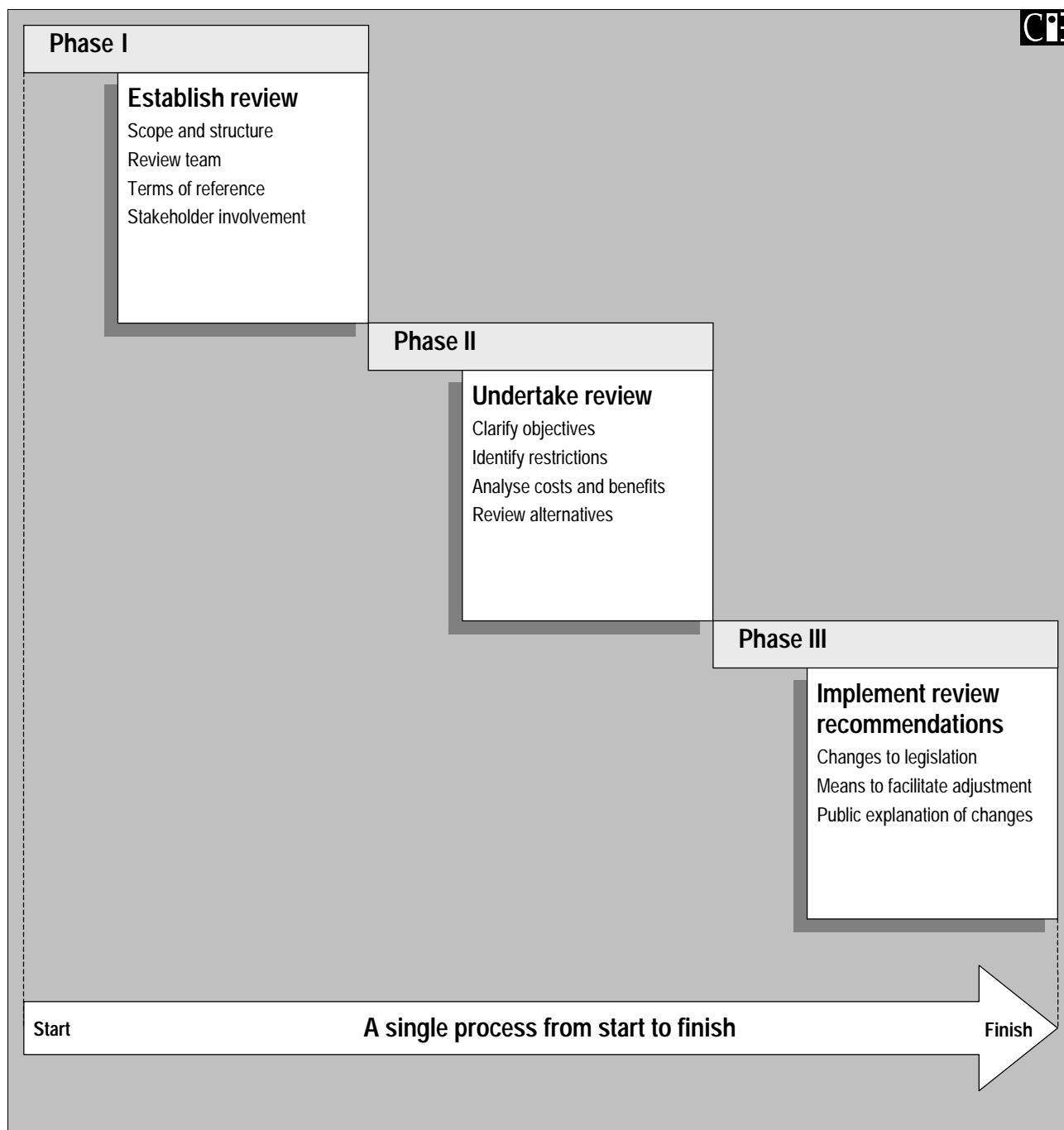
Emphasis of reviews is on community-wide benefits

- If legislative restrictions on competition are to remain, it must be demonstrated that there are benefits to the Australian 'community as a whole' from keeping the restrictions — not just benefits to vested interests or regional interests.
- Groups and interests which might need to be considered are:
 - those most directly affected:
 - producers
 - traders
 - processors
 - wholesalers
 - retailers
 - consumers;
 - those indirectly affected:
 - input suppliers
 - other industries
 - other community groups; and
 - wider community interests such as:
 - environmental concerns
 - health and safety issues
 - international relations.
- All interested parties should be given genuine opportunities to contribute to a review.

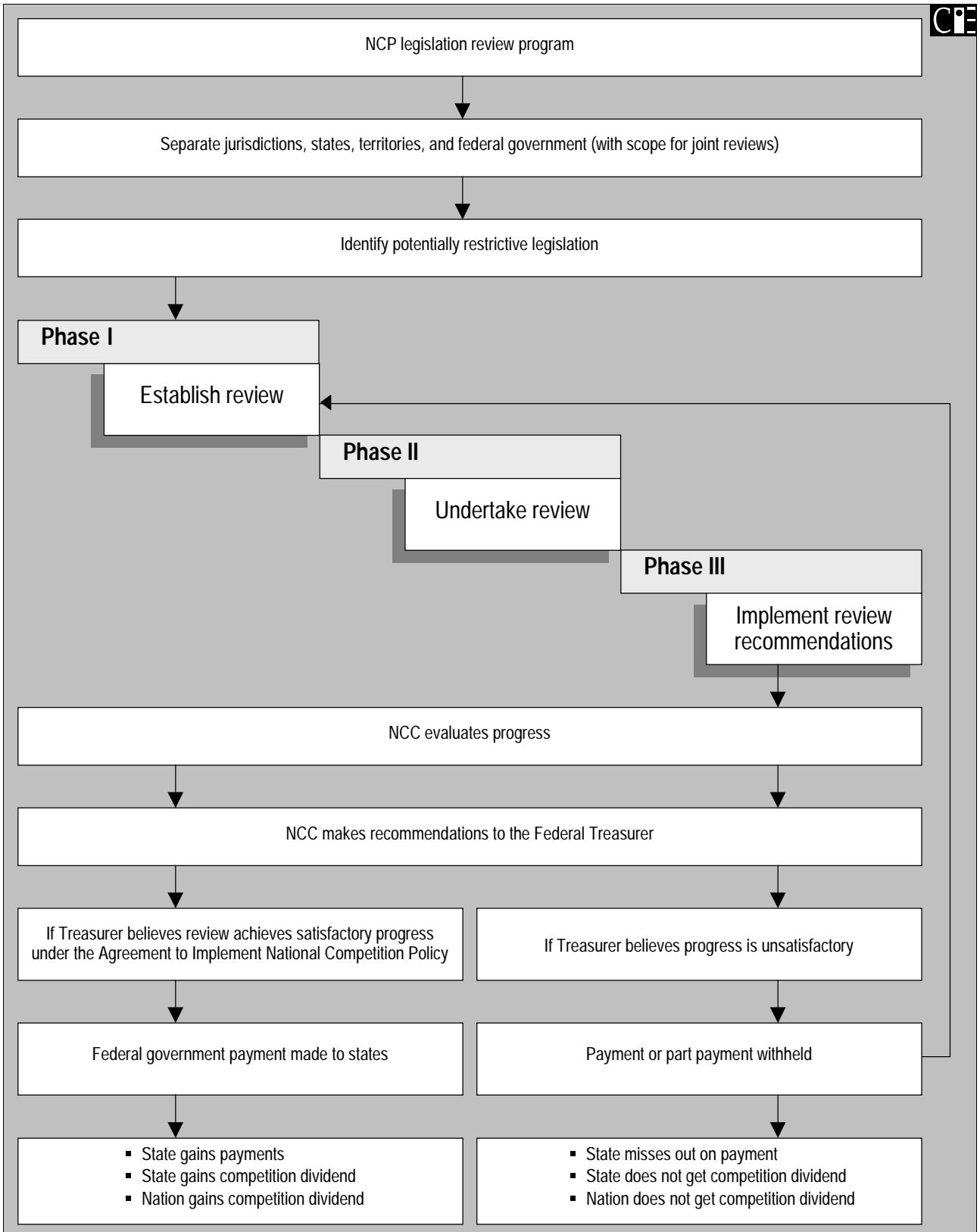
Emphasis is on improving the rules that govern our economy

- Emphasis of the approach to NCP reviews is on:
 - the quality of the outcome;
 - better rules — not necessarily on fewer rules or restrictions; and
 - demonstrating a public net benefit if restrictions are to be retained.
- Quality government and institutions (the rules) are a mark of a prosperous nation.
 - Maintaining and improving the quality of the rules requires continually adjusting them to reflect changing circumstances and knowledge:
 - the contemporary relevance of legislative objectives needs to be tested; and
 - the achievement of objectives needs to be carefully examined.
 - The CPA process contributes to the process of testing and refining the rules, which helps the economy function more efficiently:
 - objectives may need to be redefined; and
 - alternative procompetitive approaches must be considered and, where appropriate, implemented.

There are three main phases of an NCP legislation review

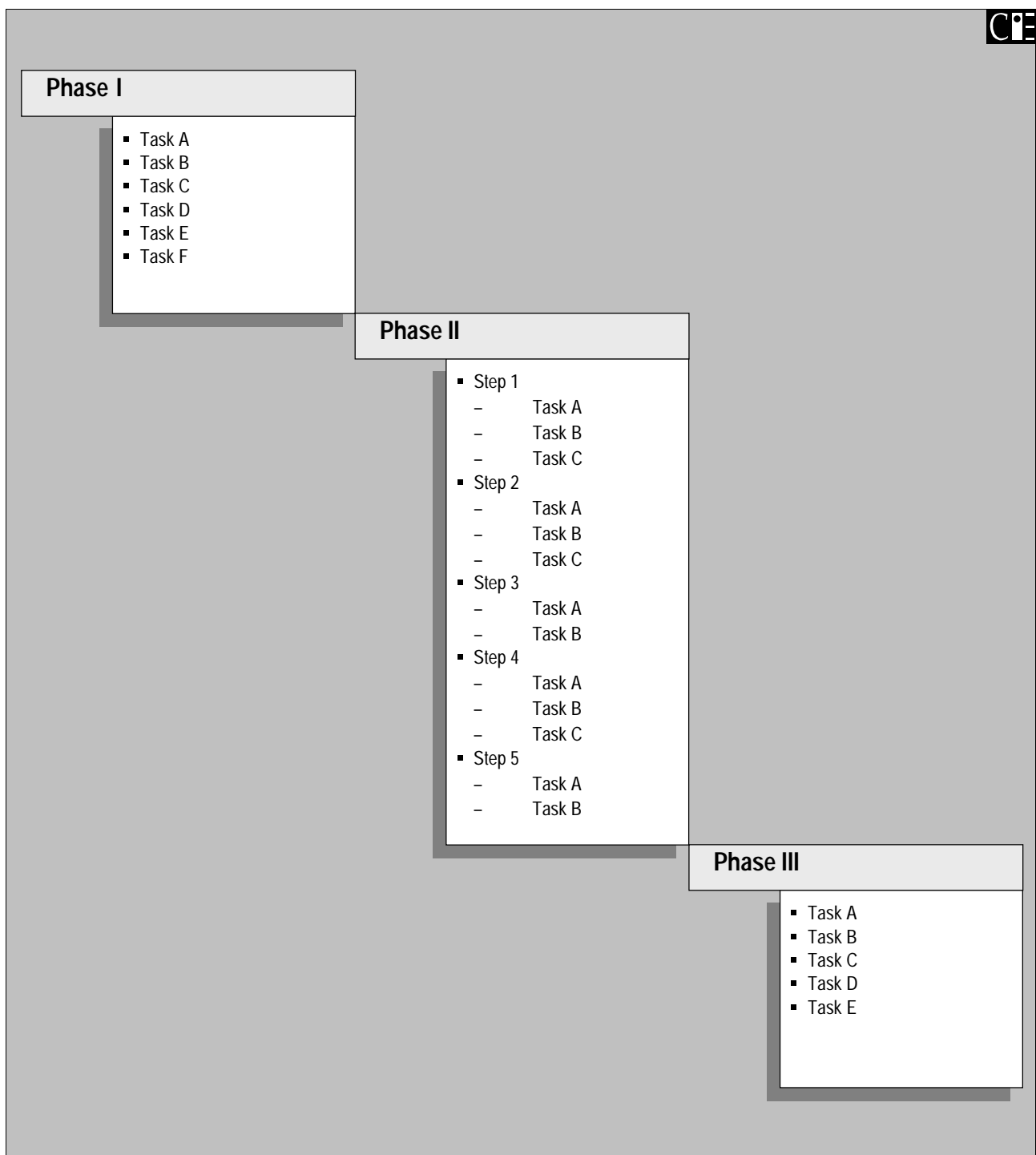


How the review fits into the NCP assessment process



The three phases break into various steps and tasks

These guidelines are structured around steps and tasks as follows.



PHASE

I *Establishing a review*

Phase I Establishing a review

Major challenges to be addressed in conducting regulatory reviews

- Typically there are many hurdles when conducting legislative reviews:
 - resistance from vested interests;
 - lack of data for analysis;
 - lack of independent analysis;
 - lack of resources and consistent economic framework for conducting analysis;
 - inability to clearly demonstrate benefits of change against apparent benefits of regulation; and
 - insufficient incentive to comply with reforms.
- These challenges must be addressed in establishing a review. Addressing each involves meeting a specific requirement or conducting a particular task as follows.

Tasks for establishing a review to address major problems

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

Task **A** *Assessing the importance of the review*

As shown below, the complexity of the review and the expected impact of the legislation will determine the importance of the review.

<p><i>Expected impact of legislation</i></p> <p><i>Complexity of review</i></p>	<p>Large impact</p> <p>Entire economy affected Particular industries greatly affected Particular regions greatly affected Big precedent established</p>	<p>Small impact</p> <p>Particular industries slightly affected Particular interest groups greatly affected Particular regions slightly affected No real precedent</p>
	<p>Complex</p> <p>Legislation complex and highly restrictive None or few previous studies Powerful interest groups Several regions affected Important downstream impacts Old legislation More than one jurisdiction</p>	<p>Big potential for misunderstanding and much at stake</p> <p>Requires maximum resources No compromise on independence</p>
<p>Simple</p> <p>Legislation only lightly restrictive Previous studies already done Interest groups unconcerned</p>	<p>Much at stake but relatively straightforward</p> <p>Must be well resourced to ensure 'right' outcome Independence likely to help</p>	<p>Little at stake and straightforward</p> <p>Lowest priority for resource allocation Tight terms of reference required to achieve as much independence as possible</p>

Task B *Ensuring an independent steering committee*

- The steering committee plays an important role in setting up the review, appointing the right review team, ensuring the terms of reference are closely adhered to and ensuring quality control.
- The committee should:
 - be headed by a representative from a government department such as Treasury or Premier and Cabinet, which has an economywide perspective;
 - exclude all interest groups from having any advisory role to the committee (but the committee should be encouraged to consult with interest groups prior to preparing the terms of reference for the review); and
 - make its terms of reference and any other documentation dealing with the process and arrangements for the review publicly available.
- Consideration should also be given to including:
 - officers with appropriate experience from the department responsible for the legislation under review; and
 - a representative from the Competition Policy Unit in each jurisdiction to ensure that principles and standards of review are adhered to.

Task **C** *Selecting the appropriate review model*

The following table helps identify the appropriate model for review.

<i>Dimensions of review</i>	<i>Measure of importance</i>	<i>Big potential for misunderstanding and much at stake</i>	<i>Much at stake but relatively straightforward</i>	<i>Big potential for misunderstanding but stakes not high</i>	<i>Little at stake and straightforward</i>
	<i>Type of review</i>	<i>Full independent public review</i>	<i>Technically focused public review</i>	<i>Stakeholder focused public review</i>	<i>Departmental review</i>
Steering committee	Credibility of committee's independence needs to be clearly established	Refer to criteria (task B)	Credibility of committee's independence needs to be clearly established	Refer to criteria	
Publicity	Wide as possible	Wide as possible	Targeted	Targeted	
Terms of reference	Broad and widely publicised with supporting documentation	Highly focused and publicised	Focused but widely publicised	Focused and publicly targeted	
Review team	From outside government and all selection criteria (see task E) should be strictly applied	From outside government and selection criteria should be appropriately applied to ensure a publicly credible outcome	From outside government with the criterion on independence strictly applied and others applied as appropriate	From inside government with selection criteria appropriately applied with particular emphasis on ability to apply an economic framework	
Consultation	Wide as possible	Targeted at obvious interest groups	Targeted at obvious interest groups	Targeted as needs be	
Public submissions	Widely publicised call	Interest groups encouraged	Interest groups encouraged	Targeted if required	
Issues paper	Widely distributed and promoted	Targeted distribution	Targeted distribution but widely available	Unnecessary	
Draft report	Assessed by steering committee and independent outsider for adherence to TOR and economic consistency	Assessed by steering committee for adherence to TOR and economic consistency	Assessed by steering committee for adherence to TOR	Assessed by steering committee for adherence to TOR	
Final report	Publicly available	Publicly available	Publicly available	Summary and press release required	

Task ***D*** ***Drawing up detailed terms of reference***

- Detail the NCP context of the review including NCP main principles and requirements.
- State the legislation for review and the specific anticompetitive elements that must be addressed.
- State the nature, type or model for review.
- Detail the scope of the review, for instance the extent of industries, stakeholders or social issues affected by the legislation.
- Detail the review team's tasks in terms of:
 - NCP requirements to:
 - clarify the objectives of the legislation;
 - identify the nature of restrictions on competition;
 - analyse the likely effect on the economy of each restriction on competition;
 - assess the balance of costs and benefits of each restriction; and
 - consider alternative means for achieving the same result including nonlegislative approaches.
 - Specify consultation requirements.
 - Specify reporting requirements and timing.
- Detail the review team's required credentials in terms of:
 - independence or divulgence of conflicts of interest; and
 - experience and capabilities.

Task ***E*** ***Ensuring the best review team is appointed to conduct the review***

- Selection of the review team should be based on:
 - financial and political independence from the legislation;
 - familiarity with the principles of competition policy;
 - understanding of the legislation under review;
 - understanding of and experience in assessing how legislation may restrict competition;
 - experience in assessing how restrictions to competition may impair economic performance;
 - experience in assessing the benefits and costs of restrictions to competition;
 - understanding of the economic and social dimensions of the problem under review, including industry structures and stakeholders;
 - ability to apply an economic framework to addressing the problem under review; and
 - ability to undertake the review in a timely and cost effective manner.

Task *F* Ensuring a transparent public process with stakeholder involvement

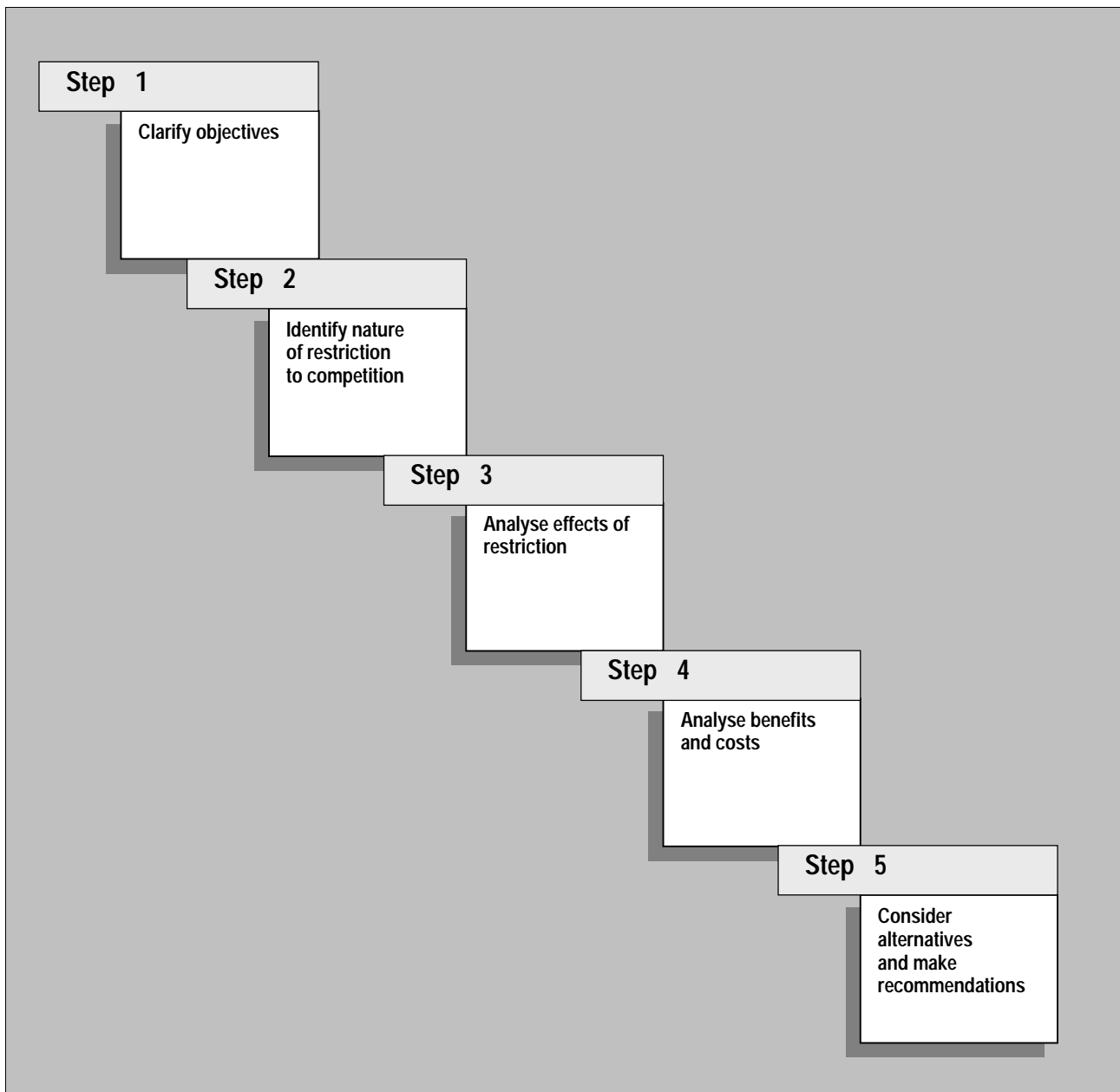
- Review models must be adhered to.
 - The steering committee must have credible credentials in terms of skills and independence.
 - The review team must have credible skills and independence.
 - Considerable emphasis should be placed on publicity, consultation, calls for and consideration of public submissions, and production of a well written report.
- The terms of reference must be adhered to.
- The economic logic in the analysis and recommendations must be consistent and be able to withstand wide scrutiny and the test of time.

PHASE

II Undertaking a review

Phase **II** *Undertaking a review*

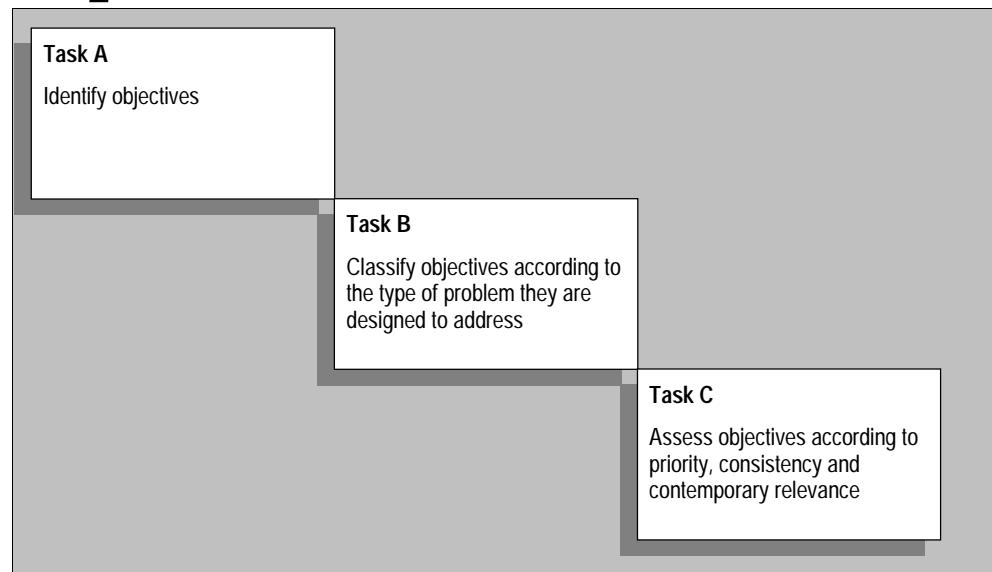
The Competition Principles Agreement specifies five main steps to undertaking a review.



Step 1 *Clarifying objectives*

- To assess how legislation may restrict competition, what economic impacts it may have, what its benefits and costs are and what alternatives may exist, an important first step is to clarify the purpose of the legislation.
- This means clearly identifying the intent of the legislation in terms of the problems it is intended to address, its relevance to the economy and contemporary issues and the issues it raises for other aspects of the NCP review.
- The main tasks to clarifying objectives can be summarised as follows.

Step 1 *Clarifying objectives*



Task **A** *Identifying objectives*

- Objectives may be explicit in legislation but they may also be implied by the impacts of restrictions to competition.
- Objectives may be identifiable from:
 - the legislation directly;
 - second reading speeches in parliament introducing the legislation;
 - subordinate legislation;
 - management plans and annual reports of institutions empowered by the legislation;
 - ministerial statements; and
 - the actions, impacts or evidence of those affected by the legislation.

Task B *Classifying objectives according to common goals, targets and problems*

- Classification into common categories of goals, targets and problems should help identify the ‘in principle’ impacts of the legislation and the contemporary relevance of what it is intended to achieve.
- **Typical goals and targets** might be to:
 - improve economic efficiency;
 - achieve certain social welfare, distributional or equity targets;
 - achieve particular environmental targets or to sustain natural resource stocks;
 - improve occupational or consumer health and safety;
 - influence regional development;
 - attract investment; and
 - facilitate adjustment.
- **Special economic problems** which may warrant legislative intervention in otherwise open markets may include:
 - natural monopoly;
 - insufficient countervailing power;
 - pricing problems relating to externalities or spillover costs and benefits;
 - pricing problems relating to the public good nature of some products and/or services;
 - unbalanced market powers relating to information asymmetries;
 - high transactions costs from too much competition; and
 - export market power.

Notes on special economic problems

- Large economies of scale and scope (doing things in a big way) may mean one producer or provider (a *natural monopoly*) can supply a good or service at much lower cost than many individual providers separately undertaking an activity.
- Presence of a natural monopoly may mean there are *insufficient countervailing powers* between producers and consumers in the market, leading to overpriced products and/or services and inefficient outcomes.
- *Externalities* arise when third parties have spillover costs (such as pollution) or benefits (such as reforestation) from economic activities that they are not a party to, and pricing mechanisms do not exist to allow third parties to charge or pay for their cost or benefit, resulting in inefficient levels of production.
- Some goods and services once produced are difficult to charge for because it is too expensive or impractical to exclude some consumers from enjoying their benefits if they do not pay — for example, footpaths. Such goods are said to be *nonexcludable* and completely open markets without a way of financing them may underinvest in their production and repair. Also, some goods and services once produced may benefit many others without rivalling the use of those who paid for their production — such as the benefits of a lighthouse. Such goods are said to be *nonrival* in consumption, and completely open markets without a way of financing them may underinvest in their production and repair. Nonexcludable and nonrival goods define what are called *public goods*.
- When information to their producers or consumers is highly uncertain or unavailable to one party, market powers may be highly uneven resulting in producers being underpaid or consumers deceived. Such *information asymmetry* may result in underproduction or overproduction of shoddy goods and services.
- High information, negotiation or contract enforcement costs between individual buyers and sellers may render an economic activity unviable. Cooperative, noncompetitive action may be required to reduce *high transactions costs*.
- If Australia has a unique product or position in an international market, it may have sufficient *export market power* to exploit foreign consumers if domestic competition is prevented.

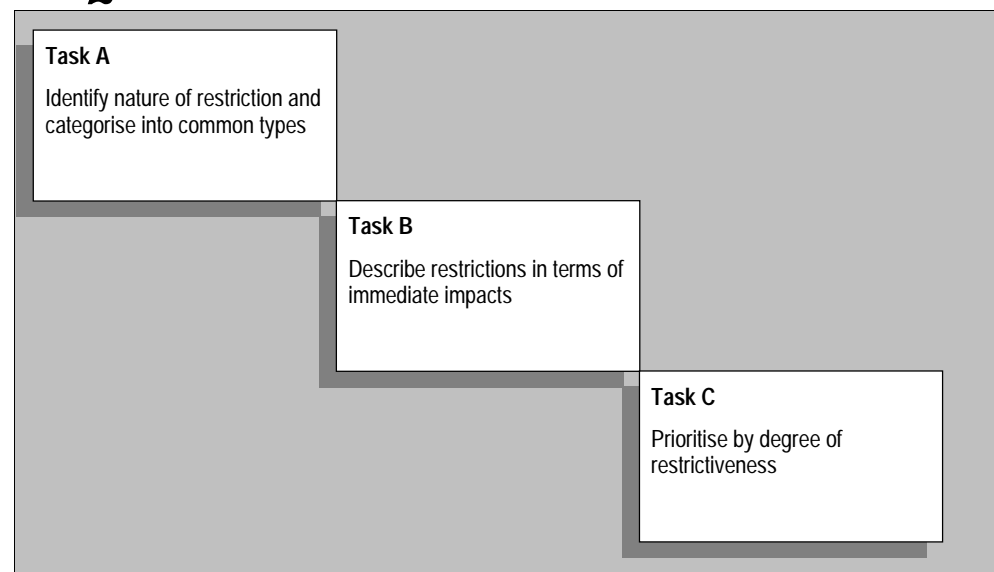
Task C *Assessing priority, consistency and contemporary relevance*

- Clarification of objectives will also involve:
 - assessing if all objectives are consistent with each other and with other policy objectives of government;
 - assigning priorities between competing objectives by identifying the means and ends hierarchy between them;
 - determining whether the objective now being pursued is the original objective targeted when the legislation was first promulgated and, if not, determining the appropriateness of the objective;
 - assessing whether the objectives are focused, practical in terms of ability to be monitored and tested, and achievable;
 - assessing whether the objectives being pursued are relevant in terms of contemporary economic problems, challenges and community attitudes:
 - asking stakeholders whether the stated objectives are sensible,
 - judging whether taxpayers and consumers would endorse the objectives,
 - judging whether objectives reflect the NCP; and
 - determining whether objectives should be:
 - modified,
 - reprioritised,
 - deleted,
 - augmented, or
 - accepted.

Step 2 *Identifying the nature of restrictions to competition*

- To assess what impacts restrictions to competition might have on the economy, it is necessary to understand how legislation is restrictive and to prioritise according to degrees of restrictiveness.
- Identifying restrictiveness requires categorising by common forms of restrictions.
- The tasks in identifying the nature of restrictions are summarised as follows.

Step 2 *Identifying the nature of restrictions to competition*



Task **A** *Identifying the nature of restrictions and categorising them*

- The NCC has suggested seven main ways in which legislation may limit competition (NCC Legislation Review Compendium, 1997). Legislation could restrict competition if it:
 - governs the entry or exit of firms or individuals into or out of markets;
 - controls prices or production levels;
 - restricts the quality, level or location of goods and services available;
 - restricts advertising and promotional activities;
 - restricts price or type of input used in the production process;
 - is likely to confer significant costs on business; or
 - provides advantages to some firms over others by, for example, shielding some activities from pressures of competition.
- Legislation should be categorised by which of these restrictions it imposes.
- Some legislation may impose more than one restriction.

Task **B** Describing restrictions

Answering the following questions in consultation with stakeholders may help describe the restrictions.

<i>Type of restriction</i>	<i>Questions</i>
1. Entry or exit	Does it: <ul style="list-style-type: none"> ▪ create or protect a single buyer or seller? ▪ limit the number of operators through licences? ▪ allow licences to be freely traded? ▪ restrict new competitors with similar products entering the market? ▪ restrict who can own or operate a business? ▪ restrict entry of products or services from other parts of Australia? ▪ place large penalties on plant closure?
2. Controls on price or production	Does it: <ul style="list-style-type: none"> ▪ limit the size of operation? ▪ restrict hours of trading or operating? ▪ limit what products a firm may produce or trade? ▪ affect the location of where a business may operate? ▪ affect in any way the price that would otherwise be determined by the market?
3. Quality	Does it: <ul style="list-style-type: none"> ▪ impose quality standards? ▪ restrict any range of quality from the market? ▪ force different qualities into different markets?
4. Advertising	Does it: <ul style="list-style-type: none"> ▪ limit who may promote or advertise? ▪ limit how a product and/or service may be promoted? ▪ force businesses to promote or contribute funds for promotion?
5. Type of inputs	Does it: <ul style="list-style-type: none"> ▪ require particular methods of production? ▪ require use and purchase of inputs from a specified supplier as a condition of operation? ▪ limit access to important infrastructure? ▪ prevent the adoption of innovative methods of production and/or marketing? ▪ require specific terms for employment different from national standards? ▪ interfere in the setting of input prices?
6. Significant costs	Does it: <ul style="list-style-type: none"> ▪ impose any specific levies and/or imposts, which are not levied on all other industries? ▪ impose high administrative or compliance costs?
7. Discriminating advantages	Does it: <ul style="list-style-type: none"> ▪ advantage one firm over another? ▪ advantage government over the private sector? ▪ provide infrastructure access to one firm but not another? ▪ restrict consumer access? ▪ benefit one group of consumers over another?

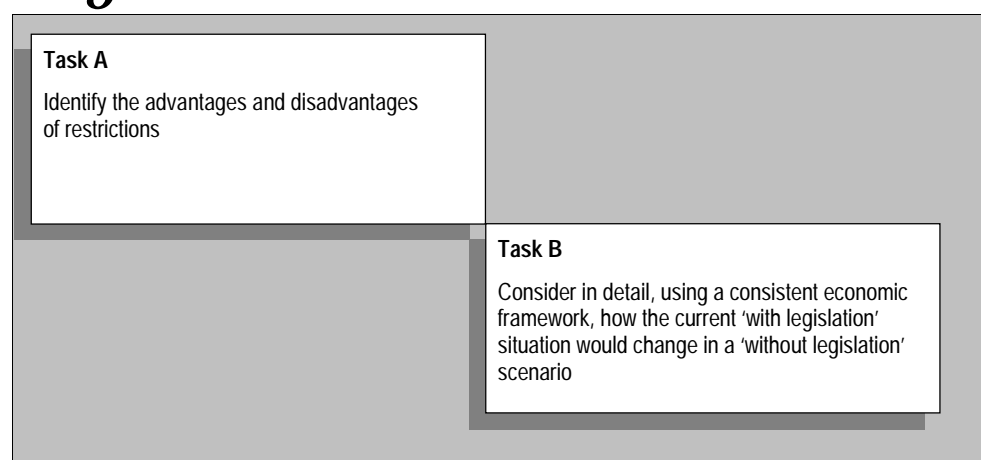
Task **C** *Prioritising restrictions*

- Where legislation establishes several powers and has more than one restrictive effect, it will be helpful to rank powers in terms of restrictiveness of each.
- The number of questions answered in the previous table may provide one indication of restrictiveness for each power established.
- Qualitative assessments about how much each restriction has altered the structure or conduct of an industry or market may also be necessary to assist in ranking and determining which powers and restrictions are most important for further analysis.

Step 3 *Analysing the effects of restrictions*

- To assess the benefits and costs of restrictions it is necessary to identify their theoretical or ‘in principle’ impacts.
- To identify the ‘in principle’ impacts requires being able to establish a framework for assessing what the commercial environment might look like without the legislation. The difference between the current ‘with’ situation and the more hypothetical ‘without’ situation will identify the in principle impact of the legislation.
- Establishing the ‘without’ framework is arguably the most important and difficult task in conducting a review. The without situation by definition does not exist. It must be constructed from theoretical evidence or from observation of similar situations in other industries or countries.
- Great care must be taken not to underestimate the benefits of the ‘without’ situation. Typically the positive impacts of moving to the without situation are understated because the benefits (although possibly large) are likely to be diffuse throughout the community and often difficult to detect and appreciate, while the negative impact may be small but concentrated, affecting a handful of operators.
- Analysing the effects of restrictions will involve two main tasks.

Step 3 Analysing the effects of restrictions



Task **A** *Identifying the advantages and disadvantages*

Determining how restrictions advantage or disadvantage the economy requires considerable experience. Working through the following table may help as a memory jogger to identify the broad impacts of restrictions. Follow up stakeholder consultation will further identify impacts.

<i>Type of restriction and advantage sought</i>	<i>Disadvantages</i>	<i>Mitigating circumstances</i>
1 Entry or exit		
Economies of scale — natural monopolies	<ul style="list-style-type: none"> ▪ No pressure for innovation and/or cost reduction ▪ High prices and lower consumption ▪ Discrimination against particular consumers ▪ Less product differentiation 	<ul style="list-style-type: none"> ▪ Competitive bidding for monopoly right for fixed period
Safety standards, for example taxi licences	<ul style="list-style-type: none"> ▪ Higher prices ▪ Reduced quantity and/or quality ▪ Enforcement costs 	<ul style="list-style-type: none"> ▪ Fully tradeable licences
Funding of and investment in difficult to price goods or services (nonrival and nonexcludable) through compulsory levies	<ul style="list-style-type: none"> ▪ May crowd out new initiatives ▪ Levies are imposts on other parts of the economy and may reduce competitiveness elsewhere in the economy ▪ No market test for whether goods and/or services are wanted ▪ Administration costs ▪ One group cross-subsidises others ▪ Resources locked into unproductive areas of the economy 	<ul style="list-style-type: none"> ▪ Competitive bidding to provide goods ▪ Voting for continuation of levies
Raise standards, for example ownership controls over casinos	<ul style="list-style-type: none"> ▪ May be used politically to exclude operators with new ideas ▪ Administration, compliance and enforcement costs 	<ul style="list-style-type: none"> ▪ Arms length regulation
Retain earnings in the local economy, for example ownership controls or state government preferences for local service providers	<ul style="list-style-type: none"> ▪ May exclude operators with best ideas — missed opportunities ▪ Sets bad international precedent ▪ Costs higher 	<ul style="list-style-type: none"> ▪ Excess profits are highly taxed, for example resource rents tax
Reduce externalities, for example radio and television operator controls and casino licences	<ul style="list-style-type: none"> ▪ Higher prices — reduced consumption ▪ Less innovation ▪ Transactions costs 	<ul style="list-style-type: none"> ▪ Competitive bidding for licences
Exploit export market power	<ul style="list-style-type: none"> ▪ No assurance that market power can effectively be exploited and may result in undetectable losses ▪ Attracts competitors and substitutes in the long term ▪ Cost featherbedding ▪ Vulnerable to political control 	<ul style="list-style-type: none"> ▪ Export market power is obvious
Guaranteed supply of strategic products	<ul style="list-style-type: none"> ▪ Raise costs/prices ▪ No market tests and reduced incentive for innovation 	

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<i>Type of restriction and advantage sought</i>	<i>Disadvantages</i>	<i>Mitigating circumstances</i>
2 Controls on production and price		
Restrictions on mergers to enhance competition and lower price	<ul style="list-style-type: none"> ▪ Adjustment retarded as efficient operators are unable to buy out less efficient operators ▪ Economies of scale may not be achieved ▪ Innovation and marketing stifled ▪ Market development impeded ▪ Vulnerable to political influence 	<ul style="list-style-type: none"> ▪ If economies of scale are small
Reduce drug taking, gambling	<ul style="list-style-type: none"> ▪ May impose large costs on nonproblem consumers in terms of reduced consumption and higher prices ▪ May raise price and force activity underground with higher profits ▪ Compliance costs 	
Reduce externalities or exploitation of a natural resource	<ul style="list-style-type: none"> ▪ May limit economies of scale ▪ May limit innovation 	<ul style="list-style-type: none"> ▪ If quotas tradeable
Achieve more desirable distribution of income	<ul style="list-style-type: none"> ▪ Higher costs ▪ Loss of innovation ▪ Enforcement costs 	
Control standards as in the medical profession	<ul style="list-style-type: none"> ▪ May result in inefficient levels of production ▪ Underdevelopment of risk spreading measures 	<ul style="list-style-type: none"> ▪ Lack of standards may be risky
Stabilise or fix price	<ul style="list-style-type: none"> ▪ Cause consumers to substitute to less suitable products ▪ Reduce incentive for product differentiation and innovation ▪ Retard marketing 	
3 Quality		
Better safety or quality	<ul style="list-style-type: none"> ▪ May crowd out commercial initiatives which set higher standards ▪ May impede development of unique quality markets ▪ Raise costs ▪ Transactions costs ▪ May be used to exclude more competitive rivals 	<ul style="list-style-type: none"> ▪ Strong industry input to setting of standards
4 Advertising		
Increase demand through compulsory promotion — avoids underinvestment in promotion	<ul style="list-style-type: none"> ▪ Crowd out better private initiatives ▪ Generic promotion divorces promotion from marketing ▪ Crowds out full strategic marketing initiatives ▪ Rewards least efficient and penalises most efficient operators ▪ Reduced product innovation and differentiation 	<ul style="list-style-type: none"> ▪ Little scope for quality improvement or differentiation in the absence of compulsory advertising
Increase information to improve choice	<ul style="list-style-type: none"> ▪ May harm most efficient operators and crowd out private initiatives 	
Reduce fraudulent behaviour and misinformation	<ul style="list-style-type: none"> ▪ May penalise nonfraudulent operators 	

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<i>Type of restriction and advantage sought</i>	<i>Disadvantages</i>	<i>Mitigating circumstances</i>
5 Types of inputs		
Reduce externalities or exploitation of a natural resource	<ul style="list-style-type: none"> ▪ May cause less efficient pattern of input use, raise price and lower output and consumption 	<ul style="list-style-type: none"> ▪ If control makes input price better reflect its full economic cost
Achieve more desirable distribution of income	<ul style="list-style-type: none"> ▪ Higher costs and loss of jobs elsewhere ▪ Loss of innovation and jobs in the long term 	<ul style="list-style-type: none"> ▪ Sector/economy may suffer if uneven income distribution leads to reduced social cohesion
6 Significant costs		
Reduce externality, for example gambling/smoking	<ul style="list-style-type: none"> ▪ May harm nonproblem consumers ▪ Vulnerable to political manipulation ▪ Cause substitution to less efficient alternatives 	
Fund nonrival and nonexcludable products	<ul style="list-style-type: none"> ▪ Crowd out private initiatives ▪ No market test for whether goods and services wanted ▪ One group may cross-subsidise another ▪ Resources locked into potentially unproductive areas by the economy 	
7 Discriminating advantages		
Achieve more desirable distribution of income by favouring one business over another	<ul style="list-style-type: none"> ▪ May impede adjustment by encouraging inefficient firms to remain and prevent more efficient firms taking over the less efficient ▪ Higher prices ▪ Less innovation 	

Further notes on disadvantages: costs

Restrictions can essentially impose three major types of costs.

- Administration, enforcement and compliance costs
 - Government, as administrator, may incur operating, monitoring and enforcement costs to ensure the restriction is effective.
 - This may be funded by taxes in which case it should be remembered that the cost of raising one tax dollar may be between \$1.20 and \$1.50, so costs are 20 to 50 per cent higher; or
 - funding may be by direct industry or consumer levies, which will also have costs beyond their direct costs.
 - Industry or consumers may incur extra direct costs in complying with standards set by restrictions and in bookkeeping to prove compliance.

- Losses of technical and allocative efficiency
 - Business, as the regulated sector, may incur costs indirectly where restrictions prevent them from: achieving economies of scale; adopting new technology or a quality standard which lowers their cost of production; introducing a new product or service; expanding into a new market; or producing at a level of output they regard as optimal.
 - Consumers may indirectly suffer the consequences of less rivalry between firms which could lead to: less pressure for innovation, new products or product differentiation; less pressure to reduce costs; higher prices and fewer products or services which effectively lower consumer spending power and incomes; less information to consumers to make optimal purchasing decisions; less choice of where to buy; and less income due to resources being locked in to, or overinvested in, sectors of the economy with low productivity.

- Losses of economic growth may occur if lower technical and allocative efficiency means the economy is not pushing out its production possibilities frontier as quickly as it could, retarding unforeseen new opportunities and reducing investment possibilities.

See also Hahn, R. and Hird, J. 1990; *The costs and benefits of regulations: review and synthesis*, Yale Journal of Regulation, Vol 8, pp. 233, and the various states' NCP guidelines.

Task **B** *Considering in detail the impact of removing the legislation*

Describing the expected positive or negative impact of removing the legislation by the variables identified in the policy impact matrixes below will help establish the 'in principle' effects of the legislation.

Policy impact matrix: obvious quantitative impacts

<i>Economic variable</i>	<i>Positive impact High/Medium/Low</i> ?	<i>Negative impact High/Medium/Low</i> ?
<p>Factors affecting revenue streams</p> <p>Prices of output directly affected</p> <ul style="list-style-type: none"> ▪ Producer ▪ Processor ▪ Consumer ▪ Retailer <p>Quantity of output</p> <p>Quantity consumed and effect on quality</p> <p>Price of other outputs indirectly affected</p> <p>Quantity of output and consumption of substitutes</p> <p>Total revenue (Australiawide)</p> <ul style="list-style-type: none"> ▪ Producers ▪ Processors ▪ Consumers ▪ Retailers ▪ All groups 	<p><i>This information will provide measures (indications) of how output, producers' gross revenues and consumers' incomes will change due to removing restrictions</i></p>	
<p>Factors affecting cost streams</p> <p>Price of inputs/unit of output</p> <p>Quantity of inputs</p> <p>Substitution to other inputs</p> <p>Cost of compliance</p> <p>Cost of administration and enforcement</p> <p>Total costs (Australiawide)</p>	<p><i>This information will provide measures of how patterns of inputs and costs of production will change</i></p>	
<p>Government revenue streams</p>	<p><i>This information will show how the government's fiscal position is affected</i></p>	
<p>Total economic gain or loss (Australiawide)</p> <ul style="list-style-type: none"> ▪ Producers ▪ Processors ▪ Retailers ▪ Consumers ▪ All groups 	<p><i>This information will provide measures (indications) of how producers' incomes, consumers' net incomes and the community as a whole are affected by restrictions</i></p>	

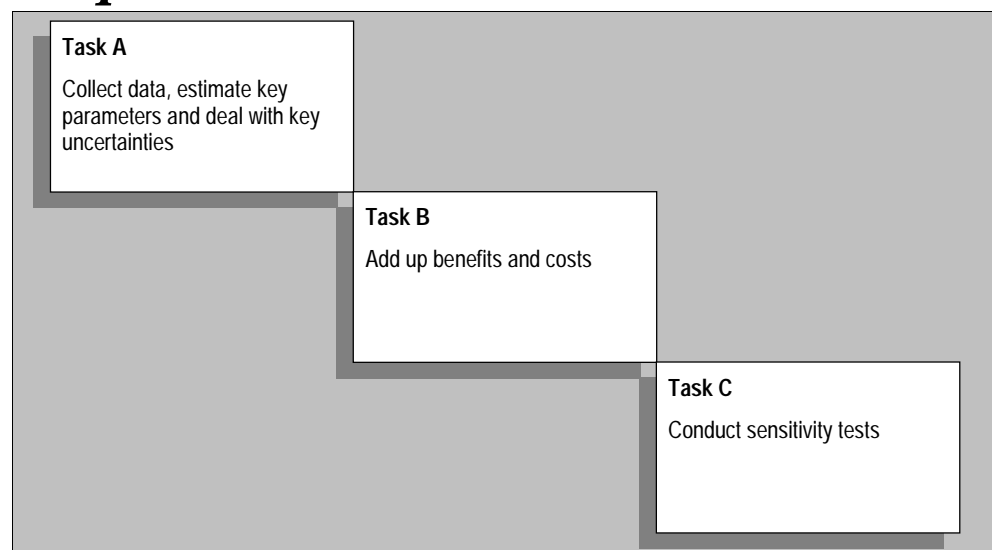
Policy impact matrix: other impacts

<i>Economic variable</i>	<i>Positive impact</i> ? <i>High/Medium/Low</i>	<i>Negative impact</i> ? <i>High/Medium/Low</i>
Number of operators Number of new entrants Amount of new investment Expenditure on R&D and innovation Exposure to risk and risk of policy failure Number of direct and indirect jobs Prosperity of other Australian industries Incidence of health and safety concerns Incidence of externalities Number of new products Amount of product differentiation Measures of product quality Level of consumption Political or lobbying activity	<i>These data will provide qualitative and quantitative indicators of advantages or disadvantages of restrictions</i>	

Step 4 *Analysing benefits and costs*

- In this step, the economic effects identified in the impact matrix (step 3, task B) need to be quantified as closely as possible given the resources available.
- Typically, quantification is an expensive component and it is theoretically demanding to ensure that benefits or costs are not double counted or misrepresented.
- As much as possible key parameters affecting benefits and costs need to be identified in the impact matrix and quantification of these needs to receive priority. Less important parameters and uncertain parameters can be considered in a probabilistic manner and through sensitivity analysis.
- Where quantification is difficult, qualitative or subjective assessments of key parameters need to be attempted so benefits and costs can at least be listed and ranked. A subjective or probabilistic assessment can then be made about whether there are likely benefits or net costs. Where a net benefit case for retaining restriction cannot be made, the presumption of cost suggests restrictions should be removed.
- Due to the cost and uncertainty of data and the need for public scrutiny and transparency, it is important all assumptions about key parameters be clearly stated and backed up with as much evidence as possible.
- This step involves three main tasks.

Step 4 **Analysing benefits and costs**



Task **A** *Collecting data, estimating parameters and dealing with key uncertainties*

- Data on the current ('with legislation') state of variables in the policy impact matrix will need to be collected from official sources or stakeholders.
- Data on variables for the 'without legislation' state will need to be estimated from:
 - subjective assessments of key stakeholders;
 - international benchmarks;
 - accounting models;
 - engineering models; and
 - economic models.
- Some stakeholders may have long considered the possible 'without' situation or experienced it in other countries and may be valuable sources of information which can be considered in a probabilistic framework — obvious care must be taken to verify the information.
- International benchmarks can be a good source of information, but careful checking of their local relevance needs to be made and their applicability to the local situation needs to be made transparent.
- Accounting models may be particularly helpful in explaining some aspects of costs, but they are unlikely to provide much insight about price and market interactions and whole economy effects.
- Engineering models may be an important source of technical input-output relationships, but costs and prices will not be included.
- Economic models will combine benchmarking, accounting and engineering data in a framework explaining economic behaviour and which can be used to help project what could happen to price, quantities, input usage and impact on the rest of the economy. Models include value chain, sector specific and economy-wide models.
- Important parameters that are too difficult or expensive to estimate will need to be guesstimated or assumed and should span a feasible range. The basis of the assumptions and ranges will need to be made clear. The range for such parameters could form the basis for sensitivity testing later.

Task **B** *Adding up benefits and costs*

- Full, consistently specified economic models will automatically add up the correct measures of community-wide economic benefits and costs.
 - Benefits need to consider measures of consumer and producer surplus — real GDP, real consumption and their components (see box below).
 - Economic costs need to account for direct and indirect costs, including externalities and whole economy macroeconomic charges, such as interest rate (or exchange rate) changes.
- Without a fully specified economic model, a simple benefit-to-cost accounting framework could be used to weigh costs against benefits.
 - Care needs to be taken to balance like with like — discounting may be important.
 - Indications of producer surplus may need to be calculated from partial measures — simple changes in consumer prices will not alone reflect economic gains to consumers.
 - To properly account for externalities, partial measures of producer and consumer surplus may need to be considered.
- The important thing is that if legislation is to be retained, it must be clearly demonstrated that the benefits to the whole community exceed costs to the whole community (including hidden costs).

What are producer surplus and consumer surplus?

Producer surplus is akin to profit before tax in an accounting sense in that it measures what producers receive for outputs over what they pay for input, less any subsidies, while consumer surplus measures how much consumers would be willing to pay over how much they actually pay — most consumers would be prepared to pay more than they do.

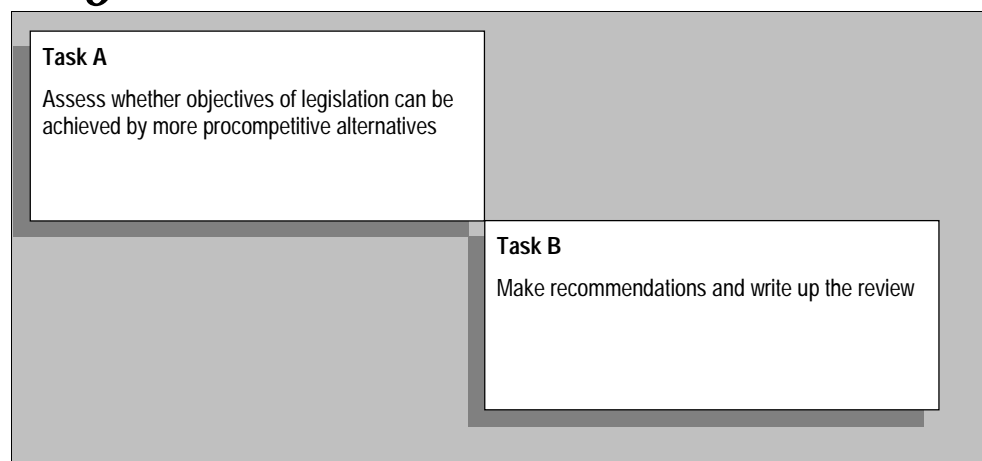
Task **C** *Conducting sensitivity tests*

- Given the uncertainty of important economic parameters it may be necessary to test the robustness of the benefit-to-cost results by varying parameters over their likely range.
- A stochastic or probabilistic approach could be followed if a fully specified economic model exists. The uncertain parameters could be assumed to randomly vary over their probabilistic range and the model would need to be run many times to generate a probability distribution of benefit-to-cost outcomes. The results will show the probability of the benefit-to-cost outcome being positive or negative.
- The alternative approach is to assign extreme values of the uncertain parameters and recalculate the benefits and costs. If extreme values do not cause net benefits to change from negative to positive or vice versa, the results would appear robust.
- It would also be possible to solve for the values of the uncertain parameters that cause a net benefit to change to a net cost. The values calculated could then be assessed to determine whether they sit within a feasible range or not.
- A key objective of sensitivity analysis is to discover the circumstances under which the *policy recommendation* from the analysis would change. These circumstances can then be checked against likely outcomes in the real world.

Step 5 *Considering alternatives and making recommendations*

- If, on the balance of probabilities, net benefits of restrictions to competition are negative, the guiding principle of NCP requires the legislation to be removed.
- If, on the balance of probabilities, net benefits of restrictions to competition are positive, NCP principles require further assessment to determine if the objective of the legislation can be achieved by more efficient, procompetitive means.
- Only where better alternatives do not exist and there are net public benefits for the whole of Australia should legislation be retained.
- This step involves two main tasks:

Step 5 *Considering alternatives and making recommendations*



Task **A** *Assessing procompetitive alternatives*

- This task may require considerable creativity to devise new alternatives. And the economic merits of alternatives may need to be convincingly argued if change is to be achieved.
- The following table showing procompetitive alternatives to common reasons for government intervention in markets may help to generate ideas. (See also: *A Guide to Regulation*; Office of Regulation Review, 1997, first edition, October)

<i>Typical reason for legislative restriction</i>	<i>Alternative procompetitive approaches</i>
Natural monopoly	<ul style="list-style-type: none"> ▪ Ensure no barriers to substitutes ▪ Ensure exposure to international competition ▪ Competitively contract private management companies to manage government owned or leased assets for specified terms ▪ Create negotiable rights to access monopoly facilities to permit competition to infrastructure in upstream or downstream activities ▪ Impose tax on super normal profits
Insufficient countervailing power	<ul style="list-style-type: none"> ▪ Use general competition laws to discourage anticompetitive behaviour ▪ Encourage more contestable market structures ▪ Allow mergers in the under-powered sector
Negative externalities	<ul style="list-style-type: none"> ▪ Impose a tax or charge on the activity so financial costs are better aligned with economic costs ▪ Create tradeable but limited rights to engage in the harmful or depleting activity ▪ Impose and enforce minimum standards to minimise externalities
Positive externalities	<ul style="list-style-type: none"> ▪ Create tradeable but limited rights (like patents) so firms can charge higher prices for a limited period to be rewarded for their contributions ▪ Provide tax concessions or subsidies ▪ Promote the activity through publicity and education
Public or nonrival, nonexcludable goods and services	<ul style="list-style-type: none"> ▪ Allow private toll gates to be erected in public places ▪ Encourage and facilitate new technologies which enhance charging ▪ Facilitate voluntary levy collection ▪ Publicly provide the service through competitive bidding ▪ Provide tax concessions or subsidies
Information asymmetry	<ul style="list-style-type: none"> ▪ Facilitate and encourage use of product guarantees, warranties, consumer associations and tests, promotion between rivals and the establishment of brokers and agents ▪ Set minimum standards ▪ Set accreditation tests for consumers or producers ▪ Impose strict penalties on false advertising ▪ Facilitate litigation against fraudulent practice
High transactions costs	<ul style="list-style-type: none"> ▪ Facilitate use of standard and simplified contracts ▪ Remove barriers to economies of scale in contracting ▪ Facilitate vertical integrations and strategic alliances
Export market powers	<ul style="list-style-type: none"> ▪ Create tradeable but limited access rights and sell to highest bidder ▪ Tax exports

*Task **B** Making recommendations and writing up the review*

- Recommendations should naturally flow from assessing alternatives.
- It may be necessary to identify timing considerations in making recommendations and to identify groups likely to gain or lose from the changes proposed. Issues of compensation may need to be dealt with.
- If change is not recommended and restrictions to competition are to be retained, a strong net benefit for retention must be demonstrated.
- In writing up the review all recommendations and conclusions should follow clearly from the analysis conducted. All assumptions, key uncertainties and sensitivities should be made transparent.
- The report should be in a style that is easily read and understood by the public. It should:
 - be as nontechnical as possible;
 - be as practical in its conclusions and recommendations as possible;
 - highlight in simple terms the key pieces of evidence underpinning the need for change, if change is recommended;
 - clearly show how it has addressed each requirement of the terms of reference.

PHASE

III ***Implementing
review
recommendations***

Phase III Implementing review recommendations

- In its simplest form implementation involves:
 - the government receiving the review;
 - government assessing that implementing the review's recommendations would ensure it meets its agreed NCP commitments of 1995 to remove or reform all costly and inefficient anticompetitive legislation before the end of the year 2000;
 - drafting of bills for legislative change consistent with review recommendations or retaining legislation based on a credible and convincing net public benefit test;
 - passing of new legislation or presentation of the net benefit test to the NCC in defence of retention;
 - acceptance or rejection of the government's response by the Federal Treasurer based on NCC advice; and
 - subsequent payment or withholding of Commonwealth funds for NCP progress in the case of states.
- However, given the normal resistance to change, implementation is a difficult and complicated phase.

Four main obstacles may stand in the way of implementation

Sensitive political issues

- Government has no clear majority and/or mandate.
- Powerful vested interests capture the attention of government.
- The electorate is not well informed of the issues.

Poor quality review

- No clear evidence for the need to change.
- Inaccurate report with inappropriate recommendations.
- Pressure exists to implement bad recommendations.

Practicalities of change are complicated

- Much effort is required to educate the electorate.
- Complex equity issues to be resolved.
- Financially costly to the government budget.
- Administratively burdensome for government.

Cross-jurisdictional legal obstacles

Successful implementation may involve any of five main initiatives or tasks to overcome each obstacle.

Means to overcoming obstacles to implementation

<i>Initiatives or tasks to overcome obstacles</i>	Task A <i>Educate the electorate</i>	Task B <i>Ask NCC to help in making commitments and implications transparent</i>	Task C <i>Set short term sunset clause</i>	Task D <i>Schedule another review or joint review</i>	Task E <i>Engage experts to deal with practicalities</i>
Typical obstacles					
1. Sensitive political issues	✓	✓	✓	✓	
2. Poor quality review		✓	✓	✓	
3. Practicalities too complicated	✓	✓		✓	✓
4. Cross-jurisdictional legal obstacles		✓	✓		✓

Task A *Educating the electorate and releasing the report*

- Where the political sensitivities to implementation are strong, a comprehensive process of public debate may be crucial to educate the electorate of the need for change and to counter the resistance from vested interests.
- To fuel the debate it may be necessary to:
 - ensure the release of either or both the draft or final report receive adequate publicity;
 - produce a pithy, well edited summary concentrating on the key findings and pieces of evidence;
 - invite independent agencies such as the Productivity Commission, academics, other state NCP units or overseas agencies to comment on the report;
 - encourage independent editorials;
 - encourage groups, with an interest in the outcome of the review, to engage in the debate; and
 - stage an open public forum to allow both sides of the debate to be presented.
- Where warranted a publicity campaign (like that prepared for the GST) may be advantageous to educate the electorate. This may be especially important where the practicalities of a new system are highly complicated.

Task ***B*** ***Asking NCC to help in making commitments and implications transparent***

- Presenting the review, its recommendations and draft policy options for comment from the NCC, and for an assessment of their consistency with NCP commitments, may add a new focus and reason for change.
 - This may help counteract the positions of vested interests.
 - It may help bring publicity if the NCC views are made public.
- Charging vested interests with the responsibility to argue their case with the NCC may help weaken the position of the vested interest without destabilising a state government's political position.
- NCC comment may also be advantageous in exposing poor quality reviews. This may help halt implementation of inappropriate recommendations.
- Where complicated cross-jurisdictional issues emerge, NCC involvement may help to provide coordination and focus for addressing such issues.

Tasks **C** & **D** *Setting sunset clauses and scheduling another review*

- Where the lack of political will prevents implementation of sensible change, legislation should be made subject to review each political term.
 - Legislation should be given an automatic three year sunset clause.
 - A new review should be scheduled for three years hence.
- Scheduling a new review may also be necessary where complicated cross-jurisdictional issues emerge and where what one state does holds implications for what another state implements.
- In some cases the best outcome of a poor quality review may be to schedule another within a short time or force another by setting a tight sunset clause on existing legislation.

Task **E** *Engaging experts to deal with practicalities*

- Where recommendations involve establishing a new system such as tradeable quotas or privatisation, many practical details not covered by the review may need to be worked out.
- These issues may relate to:
 - financial arrangements;
 - ownership;
 - legal issues and paying compensation;
 - timing issues;
 - equity issues;
 - technical issues;
 - guarantees or systems of rewards and penalties;
 - a new regulatory watchdog body; or
 - involvement of the NCC.
- Expert advice will be needed to address these issues.
- Where dealing with practical problems is costly or administratively burdensome, especially for a small state, drawing on the experience of the NCC or larger states or the Commonwealth may help minimise costs.

Summary checklist

Establish review

- Assess importance of review
- Establish independent steering committee
- Select appropriate review model
- Draw up detailed terms of reference
- Ensure best independent review team is selected
- Ensure a transparent public process with stakeholder involvement

Conduct review

- Clarify objectives
 - Identify objectives
 - Classify objectives by type of problem they address
 - Assess objectives by priority, consistency, relevance
- Identify nature of restrictions to competition
 - Identify nature of restrictions and categorise into common types
 - Describe restrictions in terms of immediate impacts
 - Prioritise by degree of restrictiveness
- Analyse effects of restriction
 - Identify the advantages and disadvantages of restrictions
 - Consider in detail using a consistent economic framework, how the current 'with legislation' situation would change, in a 'without legislation' scenario
- Analyse benefits and costs
 - Collect data, estimate key parameters and deal with key uncertainties
 - Add up benefits and costs
 - Conduct sensitivity tests
- Consider alternatives
 - Assess whether objectives of legislation can be achieved by more procompetitive alternatives
 - Make recommendations and write up the review

Implement review recommendations

- Educate the electorate and release the report
- Involve the NCC to highlight the problem and loss of payment if implementation is unsuccessful
- Set sunset clauses and schedule another review
- Engage experts to deal with practicalities