PART 3: ASSESSMENT OF PROGRESS

The June 1996 policy statements, the 1997 annual reports, and the Council's discussions with States and Territories, indicate that, in general, the States and Territories have made significant progress against their first tranche NCP obligations. While the Council has not reported the full detail of the reforms achieved, it notes continued progress with the reform of government business activities, progress in reviewing restrictive legislation and the establishment of a national market in electricity as areas where advances have occurred.

The Council has also identified some areas where the reform agenda has not been adequately addressed. For example, some restrictive legislation has not been scheduled for review. The application of the competition principles to local government, while now underway, does not appear to have met jurisdictions' early objectives. And there are emerging competitive neutrality questions which will need to be addressed in the second and third tranche assessments of progress.

Compliance with first tranche electricity reform objectives is now well advanced, although it has proceeded according to a much later timeframe than originally set by COAG. Gas reform has been also considerably slower than originally anticipated, particularly in relation to the development of a national regulatory framework. The development and implementation of road transport reforms has also taken longer than originally envisaged, although some recent progress has been made. Given the importance of these reforms, the Council is concerned to see that there are no further slippages in implementation. The Council has placed substantial weight on the achievement of freely operating national markets in electricity and gas in assessing first tranche reform performance and intends to give high priority in the second and third tranche assessments to the timely implementation of agreed electricity, gas, water and road transport reforms.

This part of the report outlines the Council's general observations about progress with each element of the first tranche reform agenda, prior to reporting on each jurisdiction's progress and recommending on the distribution of first tranche NCP payments.

THE COMPETITION CODE

All governments have now enacted legislation introducing the Competition Code within their jurisdictions. The Council is satisfied that all States and Territories have met their reform commitments.

LEGISLATION REVIEW

Under the Competition Principles Agreement, governments have undertaken to review and reform all legislation which restricts competition such that legislation does not restrict competition unless it can be demonstrated that:

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

The review program and resulting reform, where appropriate, is to be completed by the year 2000. In addition, all new legislation which restricts competition enacted after April 1995 must be examined at the time it is proposed to ensure the restriction provides a net community benefit, and that the objectives of the restriction can only be achieved by restricting competition.

All governments have developed a timetable for the review of restrictive legislation in accordance with the requirements of the Competition Principles Agreement, and have commenced their review

programs. Governments have also produced an annual report covering progress in implementation against their review programs as required under the Competition Principles Agreement.

For the first tranche assessment, the Council examined jurisdictions' timetables, with the objective of ensuring that all legislation imposing non-trivial restrictions on competition had been scheduled for review and that processes are in place to ensure that new legislation which restricts competition is examined. The Council also considered jurisdictions' early progress against the review objectives set out in their timetables, and examined the reforms arising from some completed reviews as part of the first tranche assessment.

The Council's examination of jurisdictions' programs focused on three broad considerations relevant to assessing the adequacy of jurisdictions' performances against their reform commitments:

- the adequacy of the review agenda;
- commitment to completion of the review program and implementation of appropriate reforms by the target date of the year 2000; and
- the quality of jurisdictions' review and reform processes.

Adequacy of the review agenda

While each government's timetable provides a generally comprehensive reform agenda, the Council is not certain that each has listed all anti-competitive legislation for review. The Council has so far identified three areas of concern:

- some jurisdictions have not scheduled for review laws pertaining to casino licensing;
- one jurisdiction has given insufficient consideration to its treatment of laws ratifying agreements between governments and private sector entities, where these contain provisions such as exclusive licensing arrangements; and
- two jurisdictions have enacted or proposed legislation likely to introduce a substantial restriction on competition and are still to demonstrate the associated net community benefit.

The Council considers that failure to review the anti-competitive elements of casino control legislation and related casino agreement acts (such as exclusive licensing arrangements) is inconsistent with the spirit of the Competition Principles Agreement. However, because the review of casino licensing laws is likely to involve some complex issues and potential costs, the Council does not consider that a negative assessment for jurisdictions which have not yet programmed casino control legislation for review is warranted in respect of the first part of the first tranche of payments (due in 1997-98). Nonetheless, for the Council to reach an assessment that the intent of the Competition Principles Agreement has been satisfied for the first tranche, jurisdictions will need to agree to examine this legislation. The Council proposes to report on this matter to the Commonwealth Treasurer prior to July 1998.

Similarly, agreement or ratification laws commonly include provisions which restrict competition through, for example, exclusive licensing arrangements. Where jurisdictions have excluded such legislation from review, the Council has sought to establish that the effect on competition is trivial or that the net community benefit from restricting competition has been demonstrated. One jurisdiction is still to complete its evaluation of its agreement legislation. The Council proposes to report on this matter to the Commonwealth Treasurer prior to July 1998.

The Council anticipates that there may be other laws which restrict competition which have not yet been scheduled for review. To help identify these, the Council issued a compendium in April 1997 listing all governments' legislation review programs with the objective of encouraging greater public scrutiny of this aspect of the NCP program. The Council will raise any legislation so identified with relevant jurisdictions. The Council will also take account of any community comment concerning

the scope of the legislation review and reform program in its second and third tranche assessments of reform progress.

Governments' legislation review processes should also ensure that new legislation which restricts competition is systematically examined at the time it is proposed to ensure that the restriction provides a net benefit to the community and that the objective of the legislation can only be met by restricting competition. All jurisdictions have in place formal mechanisms by which the competition policy implications of new legislation are examined. The Council is seeking assessments of the net community benefit associated with restrictive legislation from two jurisdictions. The Council proposes to report on this matter to the Commonwealth Treasurer prior to July 1998.

Completion of the review and reform program on time

The Council has consistently sought to ensure that governments are in no doubt that the review and reform process should be completed on time – by the end of the year 2000 – if they are to receive a positive assessment of reform performance.

All governments have stated that they intend to complete their review and reform programs on time 'where appropriate, in accordance with the intent of the Competition Principles Agreement', although some have indicated that there may be a need to phase reform implementation over a period extending beyond the year 2000. The Council accepts that there may be cases where phasing of reform is necessary, such that reform is not fully implemented by the end of the year 2000. However, phasing beyond 2000 should occur only in exceptional circumstances and would need a strong public interest justification. The Council would have little sympathy for phasing beyond 2000 where a jurisdiction schedules complex reviews, or reviews likely to recommend reforms with substantial phasing-in periods, late in the review period.

One indicator of governments' commitment to the year 2000 target is their early progress against the review objectives set out in their June 1996 timetables. The Council is satisfied that all jurisdictions have made reasonable progress against their published agendas.

Quality of review and reform processes

The quality of the review and reform processes adopted by governments is important. Reviews should be bona fide examinations of anti-competitive arrangements and should aim at genuine reform. The Council has received some complaints from external parties about the composition and method of operation of some jurisdiction's reviews, and about the scope and availability of review terms of reference. In addition, in one case considered by the Council, a government has chosen to retain an existing restriction on competition even though the review recommended that pro-competitive reform is likely to be in the public interest.

For jurisdictions to be assessed as having achieved satisfactory progress, the Council considers it essential that reviews genuinely countenance reform. Moreover, decisions to reform restrictive arrangements need to have regard to review findings. The Council considers that governments which elect to retain restrictions in the face of review recommendations to the contrary without providing a convincing community benefit case have failed to meet the spirit of the Competition Principles Agreement.

Given that the legislation review and reform program has only recently commenced, the Council has had little opportunity to date to examine the alleged breaches of review process. As a consequence, the Council has not placed great weight on matters of review process in its first tranche assessment. However, it is likely that the community will demand greater attention to arrangements for consultation and participation as the legislation review program proceeds. The Council sees

community participation in reviews as desirable, and will take account of the quality of review processes in its assessments of second and third tranche reform performance.

COMPETITIVE NEUTRALITY

All governments have published a policy statement covering the application of competitive neutrality policy and principles and an annual report covering the detail of reform performance in this area. To accord with the requirements of the Competition Principles Agreement, the policy statements included an implementation timetable and a complaints mechanism. The Council's assessment of the adequacy of first tranche progress focussed on the nature and scope of the reforms proposed and progress in implementation, and on the complaints handling mechanisms and the effectiveness with which complaints have been handled to date.

Nature of reforms

The Competition Principles Agreement obliges governments to identify their significant business activities and apply appropriate competitive neutrality reforms. Governments are to apply a corporatisation model to their significant trading and financial enterprises, where appropriate, and to ensure that prices of goods and services reflect full cost attribution in the case of significant business activities for which corporatisation is not appropriate.

The proposed approach to corporatisation set out in the Competition Principles Agreement was developed in 1991 by an inter-governmental taskforce examining issues in the reform of Government Trading Enterprises. The corporatisation model developed by the taskforce contains seven key elements, including:

- a clear statement of objectives, with a clear commercial focus aimed at maximising the value of the owner government's investment in the enterprise;
- full responsibility and accountability for decisions affecting enterprise performance vested in a management board at arms' length from the owner government;
- independent and objective performance monitoring focussing primarily on commercial performance against clearly specified performance targets;
- effective rewards and sanctions pre-defined against agreed performance targets;
- competitive neutrality in input markets such that government enterprises do not face advantages or disadvantages in the cost of inputs relative to the private sector because of their public ownership;
- competitive neutrality in output markets, including the removal of any protective barriers which reduce the degree of competition faced by government enterprises and the application of the same legislative regulations facing equivalent private sector enterprises; and
- effective regulation of government enterprises such that natural monopoly powers cannot be abused.

Where corporatisation is not considered appropriate, jurisdictions are obliged to implement, where appropriate, pricing principles such that prices of goods and services reflect the full cost of production, including taxation or taxation equivalents and debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees. Regulations to which the private sector is normally subject, such as those relating to the protection of the environment and planning and approval processes, should also be imposed on government businesses on an equivalent basis to private sector competitors.

The Competition Principles Agreement extends the application of appropriate competitive neutrality reforms to significant local government business activities, where appropriate.

Implementation timetables

Each State and Territory government has set out a timetable for the application of competitive neutrality policy and principles to their significant business activities, although some governments are yet to specify these businesses or the particular reforms they intend to apply to them. The introduction of competitive neutrality arrangements to significant local government businesses has not advanced greatly, with most jurisdictions still to identify the businesses which will be subject to competitive neutrality reform. Jurisdictions have advised that they expect the pace of progress at local government level to increase from the second half of 1997.

Nonetheless, the Council acknowledges that useful progress has been achieved in establishing the environment for reform and developing a culture more accepting of change. State and Territory governments have been examining the performance of their business enterprises for some time now, and a number of larger businesses have already been corporatised or privatised. All jurisdictions have also been considering their approach to some of the more complex questions such as full cost attribution in the pricing of goods and services and the appropriate delivery of Community Service Obligations (CSOs). Each jurisdiction has produced guidelines for implementing competitive neutrality reform.

Acknowledging that reform involves some complex questions, the Council is satisfied with implementation progress to date. As the reform process continues, the Council will look in more detail at matters relevant to the effectiveness of jurisdictions' reform programs. This will encompass, in particular, consideration of the effectiveness of approaches to corporatisation including performance monitoring arrangements, application of full cost pricing principles and delivery of CSOs.

Competitive neutrality complaints

Apart from an implementation timetable, the Competition Principles Agreement requires that jurisdictions' policy statements include a complaints mechanism and that annual reports provide details of allegations of non-compliance with competitive neutrality policy.

All jurisdictions have introduced a mechanism for dealing with complaints about competitive neutrality matters. In most cases, the complaints handling mechanism is scheduled to commence formal operation on 1 July 1997 although all jurisdictions are operating an interim mechanism generally through their Treasury or NCP Unit. Four jurisdictions advised, either in their policy statement or subsequently, that they would operate an independent complaints mechanism established through legislation. The remaining four indicated that they would establish mechanisms within State Treasury portfolios. Similarly, the scope of complaints handling varies across jurisdictions, with some dealing with competitive neutrality complaints about all businesses and some confining consideration to complaints about businesses to which competitive neutrality principles are applied. In examining the effectiveness of competitive neutrality complaints handling arrangements, particularly in its future tranche assessments, the Council will take account of the degree of independence of the mechanism, the intended scope of coverage including the nature of complaints which can be lodged, the transparency of reporting of complaints and findings and the ease of access for complainants.

The Council has consistently advocated mechanisms that are independent of policy making bodies and, preferably, supported by legislation. While the Council accepts that complaints mechanisms operating within agencies which are also responsible for policy development are not inconsistent with the Competition Principles Agreement, it believes this aspect may need to be revisited in the

future if there is evidence that the complaints handling ability of internal mechanisms is compromised by their policy role. Annual reports will be a major factor as reported experience will demonstrate whether sufficient independence is provided by arrangements within policy areas of governments. Complaints, and action recommended by the complaints body, should be fully reported.

In relation to the scope of coverage, the Council views the handling and reporting of all non-trivial competitive neutrality complaints as important, rather than only those about businesses to which competitive neutrality principles are applied. Complainants should be able to question the basis of a policy or process, rather than merely whether that policy or process has been applied appropriately. In this respect, the Council supports the decision taken by some jurisdictions to deal with all complaints through the formal mechanism. Complaints provide a useful indicator of the effectiveness of the competitive neutrality policies adopted by jurisdictions and help identify areas for possible future reform. An effective complaints handling process is also likely to contribute to public confidence in a jurisdiction's competitive neutrality policy and in the NCP program more generally.

The Council accepts that it is too soon to come to final judgments on these matters, and will place considerable weight on the effectiveness of complaints handling in the second and third tranche NCP assessments.

An emerging competitive neutrality complaints issue is the appropriate treatment of complaints about businesses which are partially privatised. Given that the agreed objective of competitive neutrality reform is the 'elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities', the Council believes that complaints mechanisms need to address all complaints which arise as a result of a business's government ownership connections. This would include businesses which are part-owned by governments. The Council will examine jurisdictions' policy approaches to complaints about partially-privatised businesses as part of its subsequent tranche assessments of whether all obligations under the competition policy intergovernmental agreements are being met.

APPLICATION TO LOCAL GOVERNMENT

The Council is satisfied that all governments have made some progress towards implementing reform proposals in cooperation with local government, particularly in informing local government about processes for the application of NCP reforms. And it is probable that implementation of reform in some States is proceeding in accordance with objectives set out in their policy statements. While implementation as planned by those jurisdictions would mean that first tranche obligations are met, the Council does not as yet have sufficient evidence to be confident that that point has yet been reached.

The Council does not believe that the slower progress to date is the result of a lack of commitment by jurisdictions. Local government is diverse in respect of the size and nature of the businesses it conducts and the specialist skills available to it. In addition, there are a number of outstanding issues with respect to the taxation of Government Business Enterprises which have provided an impediment to reform, particularly for jurisdictions with large local government enterprises.

Nonetheless, to be satisfied that application of the competition principles to local government is progressing satisfactorily, the Council would need greater evidence of substantive progress. Accordingly, the Council proposes to re-assess progress with implementation at local government level before July 1998. Local government progress will also be important for the Council's second tranche assessment. The Council's recommendation that progress be re-examined reflects its view that the generally slower progress against first tranche reform commitments is in part attributable to the taxation matter and does not warrant a negative assessment.

RELATED REFORMS

Electricity

The National Electricity Market Phase 1 (NEM1)

The major focus of electricity reform has been the establishment of a competitive national market encompassing eastern and southern Australia. COAG had originally scheduled this for July 1995, but there has been some slippage in implementation. Following from the Prime Minister's 10 December 1996 letter, governments have agreed upon a new timeframe for implementation. The Governments of New South Wales, Victoria and the ACT have established an inter-state wholesale electricity market called NEM1, as an interim step in the transition to a fully established national electricity market. South Australia indicated in November 1996 that it will wait until the national electricity market is established in full before it elects to join the market.

The establishment of competitive electricity markets in New South Wales (including the ACT) and Victoria, and the NEM1 (which links these markets) incorporates a significant number of the proposed National Electricity Market initiatives. It is effectively the first phase of the introduction of the national market.

The first stage of NEM1 is characterised by:

- electricity flows in and between State markets based on competitive bid offers received in both markets;
- initial, non-technical limits on flows between markets (designed to ease the transition) being progressively removed;
- power system security responsibilities remaining with each State; and
- separate Snowy Traders in each State managing the bidding into each State.

The second stage of NEM1 will be characterised by:

- the removal of initial limits on interstate trading;
- power system security being managed on a national basis; and
- a single entity being responsible for Snowy participation in the market.

Although there has been slippage from the original commitments to electricity reform, particularly in relation to the commencement date for the interim competitive national electricity market, a timeframe for phasing in the competitive national market is now agreed by all governments. In addition, Queensland has recently confirmed its intention to interconnect with New South Wales and Tasmania has announced its intention to proceed with a link to Victoria (Basslink) within four years. Noting these factors, the Council considers that the progress achieved by all relevant jurisdictions against the first tranche assessment objectives has been satisfactory.

Gas

The agreed reforms on free and fair trade, as set out in the February 1994 COAG Communique, are broadly divisible into three categories:

- implementation of a uniform National Access Code for the services of gas transmission pipelines (subsequently amended in the June 1996 Communique to include distribution pipelines);[12]
- removal of all legislative and regulatory barriers to free and fair trade in gas between and within jurisdictions; and
- gas industry reforms to promote competition and free trade, including the structural reform of gas utilities and the adoption of uniform national pipeline construction standards.

Many reforms are tied to implementation dates which are now lapsed. In this respect, the Council believes that the introduction of free and fair trade in gas between and within jurisdictions has fallen considerably behind the original COAG agenda.

The Prime Minister's letter of 10 December 1996 outlined a process and new timetable for implementing the National Access Code. The Prime Minister's proposals have now been agreed by all jurisdictions, except Western Australia, and as a result form the basis of the Council's assessment of progress in implementing the National Access Code. The Council's assessment has taken into account that the timetable for implementation outlined in the Prime Minister's letter will not be met and that jurisdictions are developing a new timetable through the Gas Reform Implementation Group.

In addition to the National Access Code, the Council has assessed gas reform performance against the other reform commitments and timeframe set out in the February 1994 COAG Communique (for example, the commitment to remove legislative and regulatory barriers to the free trade of gas by 1 July 1996).

Road Transport

National road transport reform was originally envisaged to occur through a six module phased approach commencing in 1995. At this stage, progress has been slower than anticipated, with only one of the original six reform modules — relating to standard heavy vehicle charges — being developed by the NRTC and implemented by jurisdictions. And in most instances, implementation took place later than originally agreed.

All jurisdictions have endorsed the program for future reform agreed on 14 February 1997 by MCRT,[13] although some jurisdictions indicated that reform progress should not be assessed on the basis of the timetable until it is endorsed by Heads of Government and the ACT indicated its capacity to implement the MCRT program is dependent on action by the Commonwealth. Notwithstanding these qualifications, the Council is satisfied that all jurisdictions have met the first tranche assessment criteria. Jurisdictions' performance against the MCRT program and timetable (subject to any change agreed by Heads of Government) will provide the criteria for the Council's second and third assessments of road transport reform performance.[14]

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12 See Footnote 7.

13 A statement by Heads of Government on road transport reform would take precedence over the MCRT timetable and would become the basis for the Council's NCP assessment.

14 The Council notes that the ability of the ACT to implement the agreed MCRT reforms may be affected by the requirement that the Commonwealth legislate in this area on behalf of the ACT.