COMPETITION REFORM, EQUITY AND POLICY LEADERSHIP

A speech by Graeme Samuel, President, National Competition Council to the Business Leaders' Forum, Brisbane, 19 November 1998

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Thank you for inviting me to speak to you today. My topic covers the relationship between competition policy and social equity, and the need for leadership in promoting reform that addresses this goal. This is an important issue, and one that I have discussed on several occasions recently. It is also one that the National Competition Council touched on in its 1998 Annual Report released last week, which showed how competition reform and equity are not only compatible but in may ways complementary.

The issue of social equity and its relationship with competition reform is also one of the matters raised in the debate about competition policy that took place in this state last week. To provide a backdrop to my broader comments, I will start by clarifying a few issues arising out of that debate.

1 The debate

As many of you will be aware, National Competition Policy was debated in the Queensland Parliament last Wednesday evening. The debate was wide-ranging and there was some disagreement amongst the speakers on detail issues. However, it is notable that all sides of the House supported a motion calling for a change in emphasis in competition policy and, indeed, some curtailment of what they saw as the role of the National Competition Council.

While I welcome informed debates about competition policy, unfortunately a number of misconceptions and, in one or two cases, quite extreme notions crept into last Wednesday's discussion. For example, NCP was linked with a range of woes, including social inequality, rural hardship, loss of the Australian way of life…and even suicide. It was also criticised as being a form of free-market economic rationalism. One speaker claimed that NCP was not bringing any benefits – only pain. And the view was also expressed that the National Competition Council has the power to over-ride the decisions of sovereign governments and slash millions of dollars from their budgets.

2 About NCP

Let me briefly clarify a few points about NCP.

Australia's governments accepted the need for broad-based competition reform when they all signed on to the National Competition Policy (NCP) reform package in 1995. In doing so, each government agreed to implement the relevant reforms in the package. There are also specific packages for four key infrastructure sectors — electricity, gas, water and road transport — tied to the reform agenda.

Generally, the NCP reforms are directed towards ensuring that, *except for those sectors for which it can be demonstrated — using rigorous and objective analysis — that there is a net community benefit in restricting competition*, every sector of the Australian economy that is currently sheltered from competition is opened to it.

The qualification is important. NCP is not, and never has been, about competition for its own sake. Rather, NCP comprises a raft of reforms that seek to harness to productivity-enhancing effects of competition, *where competition is appropriate*, to boost economic performance throughout the economy.

To guard against competition being implemented where it is not appropriate, the NCP agreements contain a public interest test. That test requires that governments, when reviewing particular NCP reform options, weigh up all the pros and cons of competition — including its effects on matters such as employment, equity and social welfare, regional development and consumer interests and well as business competitiveness and economic efficiency.

The NCP agreements also allow governments to provide *genuine* community service obligations to people in regional areas, or anywhere else for that matter.

It is still quite early days in the NCP program, of course, but already we are seeing evidence of substantial benefits. I will talk at more length about these later, but for the moment let me just say that we have seen reductions in energy prices of 50 percent or more in some instances, and 40 percent lower freight rates for certain rail services.

And the National Competition Council? The Council is a policy advisory body. We are appointed by, and report to, both the Commonwealth Treasurer and the Council of Australian Governments (COAG). Our role, in general terms, is to promote the reform program; to facilitate reform; and to monitor progress by governments in implementing the reform program.

We must also recommend to the Commonwealth Treasurer whether the states have made sufficient progress in meeting their reform commitments under the NCP agreements to warrant receiving the full NCP payments from the Commonwealth — as all parties agreed would be the case when they signed on to NCP in 1995. If the Treasurer does not like our advice, it is open for him to reject or ignore it. If governments do not like our advice, it is open for them to tell us why we are wrong and so seek to persuade us to change it, or to change the NCP and related agreements through the COAG, or to cease being parties to those agreements.

Australia's governments set up the Competition Council and gave us our advisory role. It is simply wrong to imply that, in exercising that role, we over-ride their powers.

Rather, the Council is tasked with helping to achieve the over-riding objective of all Australian governments to implement appropriate competition policy reforms to develop unified national markets to serve all Australians, rather than disaggregated monopolies to serve just a few. NCP is the antithesis of the old state versus state and state versus commonwealth argy-bargy where leadership, truth and honesty occupied a back seat to 'whatever it takes' political maneuverings for narrow short-term gain. I hope we will not see a prolonged slippage back to these 'old ways' in Queensland.

Having said that, I do not want to dwell any longer on the various misleading claims about the broad NCP package and the Council made in the Queensland Parliament last week because, in fact, what was driving that debate was much narrower.

3 Water reform

And let me be very clear about it — the real issue that has raised the Queensland Government's and former-Government's ire relates to problems they are or were having in devising a way of meeting their commitments under the COAG water reform agreement, which forms part of the overall reform agenda.

Water reform is an important issue, both for businesses, particularly those with links with rural areas, as well as Queenslanders and Australians more broadly. It is also an issue that goes to the heart of integrating economic imperatives with broader community-related issues.

This is because over $90 billion is presently invested in Australia's water infrastructure. It is a major part of Australia's infrastructure, providing water for irrigation and farming as well as industrial and urban uses. But it has also been a major drain on tax-payers, and the way the water industry has developed is causing various environmental problems. These have long-term implications for the sustainability of many rural businesses.

In the past, water seemed to be readily available. At the same time, the prices people were charged for water did not cover the costs of providing the resource. As the demand for water increased, governments responded by building more dams and increasing the availability of water. But without sufficient funds, water authorities skimped on maintenance functions, and excessive use of water caused serious environmental problems. Cheap and plentiful water certainly helped some farmers in the short run, but it left a financial and environmental time-bomb for farmers and governments to defuse later on.

The water reform package typifies a group of reforms that are designed to take a holistic approach to an important sector. Reform of financial arrangements alone would ignore the environmental and social impacts. Focussing only on the environment would put the future of important industries at risk. And focussing on short-term exploitation of the resource would undermine the rights of future generations.

The water reform package is a robust and eminently sensible approach to dealing with this valuable national resource. It involves measures to address both the economic viability and ecological sustainability of water supply. It includes reforms to water pricing, allocations and trading of water entitlements, the structure of water supply utilities, and appraisal processes for investment in new or extended rural water schemes.

If governments do not implement this package, there are several real risks.

First, there is the risk that water infrastructure will not be maintained to the standard needed by water users. The pricing reforms mean that prices for water from existing water systems will at least cover the costs of operating those systems, plus enough money to fund future maintenance. Without these changes, there is a major risk that the water infrastructure would be run-down.

That said, the agreements recognise that water users should not pay for inappropriate past investments, nor should they pay for any inefficiencies in government water utilities that inflate the costs of water services. It is also recognised that, in a few situations, the history of, say, an irrigation scheme will make full cost recovery impossible and, therefore, transparent government subsidies are likely to be necessary.

Second, there is the risk that new industries will be unable to secure the water rights they need to undertake investment. The water reform package allows for water rights to be clearly defined and traded. Without the allocation and trading of water entitlements, existing businesses would be deprived of an important asset — their right to use water and the ability to buy and sell that right. Investment in new industries will be riskier without the ability to secure long term rights to use water.

Third, there is the risk that water quality will deteriorate. To help prevent this, the water reform package includes the National Water Quality Management Strategy which focuses on protecting and enhancing water quality, including guidelines to raise national drinking quality standards to 1987 World Health Organisation Standards.

Another risk if the package is not implemented is that local involvement will be neglected. The package stresses the need for local involvement in water management and consultation on proposed changes. Without this involvement, centralisation could mean that inappropriate decisions are made and that local conditions are not be taken into account.

Fifth, there is the risk that more money is invested in new water infrastructure when it is not necessary or the money could be better spent elsewhere. The water agreements allow for future investment in water infrastructure when this investment is economically viable and ecologically sustainable. This test ensures that all Queenslanders benefit from the decision to undertake new investments. However, the water agreements do not allow current generations to undertake unsustainable investments at the expense of the environment, people elsewhere, and future generations.

Finally, there is the risk that water businesses will not be focussed on customer service and the best way of operating their business. The package provides for governments to separate the operation of water businesses from other functions such as resource management, standard setting and regulation. This ensures that water businesses can focus on their business and do not face conflicting objectives or unclear goals.

The various risks I have mentioned are most prominent in the Murray-Darling Basin. This Basin comprises about one quarter of Australia's land mass. It covers significant parts of Queensland, New South Wales, Victoria and South Australia, and contains most of Australia's cultivated land. Past water usage practices are destroying this basin and already there are massive problems with salinity. Without reform, land affected by salinity could easily increase 500 percent in just a few years. For example, according to the CSIRO, more than 20 percent of the Murrumbidgee Irrigation Area is affected by rising water tables and a further 40 percent is at risk, largely as a result of current irrigation management practices.

Queenslanders are fortunate because they live upstream of the mess in the Murray Darling Basin and don't have to live with many of the consequences of the bad policies of the past. They are also fortunate that most of the rivers in this state have high flow rates and flow directly into the ocean.

But this does not mean that Queenslanders should ignore what is happening in the Murray Darling Basin, or that Queensland is immune from the consequences of poor water usage practices in the future. Anyone in Queensland who thinks that the water agreements aren't important should travel to the Murray's mouth in South Australia and observe the consequences of years of bad water policy. Along the way, they should also talk to people in New South Wales and Victoria who are also suffering the consequences of simplistic notions such as 'all dams are good' and 'development at any cost'.

Yes, water reform will mean that the price of water increases in some areas and that governments will need to look closely before deciding to invest in new dams.

But it does not preclude investment in new dams, nor does it prevent governments from subsidising water where this is justified for legitimate social reasons. The COAG water agreement does allow governments to provide genuine community service obligations (CSOs) to disadvantaged communities. At the same time, it does <u>not</u> provide scope for governments to circumvent the pricing reforms through the adoption of contrived definitions of CSOs. To do so is to undermine the whole basis for the agreement and, thus, to risk the ecological and economic sustainability of our water supply.

Overall, the water reform agreements seek to address the damage caused by bad water policies in the past, and to avoid similar mistakes in the future.

So, let it be clear that the debate about NCP in Queensland is not one about an unelected body imposing its will on a sovereign government. Rather, it is about whether a state government that is a signatory to a national agreement on a valuable national resource is willing to abide by the terms of that agreement, and whether it is willing to put economic accountability and environmental responsibility before political expediency.

4 The case for broad-based competition reform

While water reform is one element of the NCP package, the package involves a range of measures across a number of fields. Some of these measures are quite different in flavour to the water agreements. The reforms range across the various infrastructure sectors such as energy and transport to markets and industries governed by anti-competitive regulation, and government businesses.

The prospective benefits of these reforms are substantial.

In general, NCP focuses on reducing business costs and lifting innovation, product range and market penetration by harnessing the productivity-enhancing effects of competition. The lower prices that will generally flow from competition reform will make businesses more competitive. This will allow them to export more — it should be remembered that Australia is a small player in most export markets: we provide only a small percentage of global food production, for example, meaning that there is significant scope for expansion into overseas markets if we are sufficiently competitive. Further, competition can encourage greater innovation in production and marketing. Monopolies simply do not have the same incentives. Greater competitiveness will also allow local firms to displace imports on the local market, or lower their prices to expand sales. And lower prices will give consumers more money to spend on other goods and services, thereby effectively lifting domestic demand.

While it is still early days in the NCP program, we have begun to see some fairly striking evidence of the benefits of competition. These include reductions in business electricity bills for relevant businesses of around 23 to 30 percent on average; cuts in gas prices of up to 50 percent; rail freight reductions of as much as 40 percent, with improvements in transit times and service quality; and a reduction in the prices of government businesses of 15 percent while, at the same time, those businesses have doubled their payments to governments over 4 years (See attachment for details). We have also seen a streamlining of business licensing requirements; savings in water usage to help the environment; and greater 'access' to boost utilisation of valuable national infrastructure.

The further development of national energy markets offers additional benefits. For example, while electricity prices have fallen by over 20 percent since the commencement of Queensland's internal wholesale electricity market, they remain well above prices in the south. The commissioning of 'Westlink' will allow Queenslanders to get access to cheaper power, provide extra supply security, thereby helping to alleviate the likelihood of 'brown-outs', and also reduce the need for capital outlays on new generation capacity. Tasmania has also announced the commissioning of 'Basslink' which will, among other things, alleviate the possibility of supply disruptions during droughts. In relation to gas, although it is still early days, the recently commissioned $50 million 'interlink' pipeline between NSW and Victoria allowed a limited amount of Cooper Basin gas from South Australia to flow into Melbourne during the recent Longford supply disruption, enabling emergency services to be maintained. You will also be aware of the Chevron project that will bring gas from PNG to Queensland and then along the eastern sea-board.

Beyond these developments, NCP should improve the productivity and flexibility of our economy in aggregate, and thereby reduce the extent to which, and speed with which, we slide into recession in response to adverse changes in the world trading environment. In this context, it is noteworthy that the Australian economy has to date remained surprisingly (though not completely) unburned by the Asian melt-down. In fact, leading US economist Paul Krugman has recently labelled Australia a ‘miracle economy’, having successfully applied a textbook adjustment to a massive external shock. It is too soon to say that we will completely escape recession, either from the effects of the Asian crisis or the global slow-down foreshadowed by some. Nevertheless, we have fared much better so far than might otherwise have been expected. It is too simplistic to attribute this apparent fire-proofing of the economy solely to competition policy or, for that matter, the micro-economic reforms of the 1980s and early 90s, yet they surely form part of the reason.

That said, for these benefits to be realised in full Australia-wide, much more reform is required.

On the other hand, it should also be realised that NCP is neither an economic cure-all, nor the only thing governments need to do. There is a range of other matters that also need to be addressed, including tax, labour market arrangements and appropriate measures in relation to education, training, R&D incentives and infrastructure provision. (There is also the issue of how governments need to help communities adapt to change, about which I shall say more shortly). But NCP should, I suggest, form an integral part of any plan that aims for a prosperous *and sustainable* future.

As well as the economic imperatives, there are several equity benefits in prospect from robust competition reform.

First, as the NCP energy reforms expand to take in the household sector, the resultant lower power prices will have ‘progressive’ distributional effects. This is because low income households spend a larger proportion of their budget on power than do high income households. Indeed, several of the reforms, by reducing the prices of life’s essentials, will have this effect.

Second, implementation of the NCP reforms should ensure that the disciplines of competition are shared more evenly across society. At present, some groups do business from behind anti-competitive arrangements, while other people are not afforded the same privileges and, in fact, can end up paying for them. One example is the legal profession’s monopoly on conveyancing here in this State. When similar restrictions were removed in NSW in the early 1990s, conveyancing fees fell by 17 percent, saving NSW consumers of at least $86 million. In other words, these restrictions had effectively boosted the incomes of members of the legal profession, but at the expense of consumers and others wishing to compete for their custom. Of course, as you know, the Government has recently announced a review of the Queensland laws. Under NCP principles, such anti-competitive arrangements would only be justified if they provide a net benefit to the community as a whole, rather than simply profiting the practitioners.

Third, to the extent that NCP does help fire-proof us from external shocks, we can expect to avoid recessions, or suffer less serious recessions, then we otherwise would. Labour market economists are very much aware of the effects of recessions on unemployment over the last couple of decades, where we see unemployment settling back to a higher rate after each recession than that which prevailed beforehand. The aggregate level of unemployment, of course, is a key indicator of inequity in our society.

Fourth, NCP can provide the means to promote equity by enhancing our economic performance. This is most obvious in the area of government business reform. Where governments are able to provide their services more cost-effectively, they will have more resources available to meet other community needs (or, alternatively, they will not need to cut existing services as deeply to meet their perceived budget imperatives).

Having said that, some competition reform options, were they to be implemented, could detract from equity. This would be the case if, for example, a reform would cause job losses in an already depressed area that would not be sufficiently offset by more jobs elsewhere.

In such cases, the ‘public interest test’ built into the NCP Agreements requires that equity be weighed-up against other matters when a particular reform option is being reviewed. If a reform option does adversely impact on equity, this would add to the case for not implementing it. In this context, it is worth remembering that NCP is not about competition for competition’s sake. Nor is it reform for its own sake. Rather, as I mentioned earlier, it is about pursuing the broader community interest through competition where, and only where, competition will help achieve that objective. Which is as it should be.

Further, if the benefits of such a reform option do outweigh the costs, including the cost of the loss of equity, it is incumbent on governments, I believe, to ensure that appropriate adjustment assistance is available for those adversely affected by implementation of the reform. This is an issue that the Council raised in its 1996-97 Annual Report to governments — well before these issues started receiving attention from mainstream parties and commentators, it should be noted — and it has taken it up again in this year’s report.

These types of issues arise particularly in relation to rural and regional areas. I have spoken about this matter previously, and will address it again at some length in forthcoming talks with the Queensland Farmers Federation. A key point is that competition policy is not the root cause of most current regional ills — competition policy cannot reasonably be blamed for banks closing branches or substituting tellers with ATM’s, nor the demographic shifts from country to city that we are seeing in response to factors such as falling commodity prices, technological change and the increasing importance of the service sector as an employer. That said, the same broad principles of rigorous analysis of the case for competition reform, and appropriate adjustment assistance for people affected by reform, where it is appropriate, apply equally to people in rural and regional areas as apply to people affected by economic change in the cities.

However, apart from those cases where the public interest safeguards built into the NCP agreements themselves negate the implementation of a reform option, retreating from NCP reform will not be an efficient means of promoting equity — quite the reverse.

Rather, to meet the community’s equity objectives, governments need to identify and act on those policy mechanisms that are relatively efficient means of delivering equity. Again, taxation, education and labour market arrangements are obvious candidates for attention.

5 Some leadership implications for government and business

Let me turn now to the issue of leadership and what governments — and business — need to do bring about robust competition reform. I think recent events show us what can go wrong in this regard, and also provide some lessons.

The first point to recognise is that, before we endeavor to implement reform, we must recognise that other sections of the community may not share our views. Indeed, in many instances they may not have considered the issues from the business perspective or, indeed from any other, and need first to be informed and ultimately convinced as to the need for reform. These views need to be discussed in the community, to develop an understanding that there is a problem that requires to be fixed before an attempt is made to promote the merits of a solution.

The approach to any problem must recognise and reflect the interests of all elements of the community, individually and collectively, rather than the narrow interests of a reform proponent. Why should anyone support, or even acquiesce to, a reform measure which involves no apparent benefits and perhaps a few risks? Ideally everyone is a winner. Or, more realistically, there are substantially more winners than losers, and even the losers can be shown to have been treated fairly and equitably, and compensated for their loss where appropriate.

Business will clearly have specific requirements in relation to those areas of reform that it urges government to address. But business has to recognise that there is a much larger community whose needs, aspirations and concerns must be addressed if reform is to be embraced by the community at large.

Reform needs to be embraced, by the community as a whole — not just individual sectors. Accordingly, the community, in the broadest sense of that word, needs to be involved from the earliest stages of any reform process. Community involvement provides a focus and a sense of proprietorship over any solution. Where solutions are formulated by individual sectors in isolation, there is a high probability that other sectors of the community will view those solutions with suspicion and as merely serving the self-interests of the proponents.

At the same time, there is also a need for leadership in pursuing reform. To my mind, leadership is promoting a concept or idea with a conviction that it has merit, rather than merely because it is perceived to be popular. Certainly, politicians and business leaders have a responsibility to represent the interests of their constituencies. But sometimes, political leaders and business leaders have, through their knowledge and training and access to expert advice, a better appreciation what is in the interests of their constituents than their constituents do. Leadership in such circumstances means informing the constituency and promoting what is right, rather than exploiting ignorance for short-term personal or political gain.

Recent events should suggest to governments, or aspiring governments, that there are some dangers in seeking to exploit community fears and ignorance for short-term gain, or engaging in a "race to the bottom" in policy terms. Populist economic and social policies may work well for a while, but simplistic policies ultimately become easy targets.

Of course, building a constituency for change can sometimes involve the expenditure of some political capital. That is, there may well be some short-term flak for those who dare to lead.

But Australians want and expect strong leadership, and have demonstrated many times their propensity to adapt their views to new evidence. Indeed, the propensity of voters to judge the performance of governments with the benefit of hindsight may help explain why strong political leaders are popular, even though their terms of office may be dominated by what at the time are controversial and unpopular reforms.

I recall the comments of noted English commentator, Paul Johnson, during a visit to Australia way back in 1982. He noted that both the Thatcher and Fraser Governments were facing imminent elections. He predicted Thatcher would win, because she had the courage of her convictions, while Fraser would lose — because he did not. Johnson was right on both counts.

Closer to home and closer to now, governments willing to tread the reformist path have seen some positive returns lately. The Victorian experience is a case in the point. So is the federal Coalition's turn-around in the polls after it announced its tax reform package. Conversely, its earlier electoral decline arguably shows what can happen when policy drifts.

6 Summing up

Let me conclude by refocusing your attention on some key points.

While it is still early days, competition policy is already bringing benefits and remains a vital ingredient in any serious program to provide a prosperous and sustainable future for Australians. It is a balanced program of reform, combining both economic accountability with social and environmental responsibility. It means additional adjustment pressures for some sectors, but allows for carefully targeted adjustment assistance and the provision of community services. Implementation of the NCP program will also enhance equity in many respects.

But bringing about robust competition reform is not simple, particularly in a climate of significant misinformation in which some political figures are willing to engage in whipping boy tactics and to put short-term political expediency ahead of the longer-term community interests.

And we in the business community — as an important component of the broader community — have a responsibility to collectively promote balanced and broad-based competition reform and to demand from our governments honest political leadership on this matter.

Attachment:
some early outcomes from competition reform

- Electricity bills have fallen about 23 to 30 percent on average, and up to 60 percent in some instances, for those Victorian and NSW businesses covered by the national competitive market, while wholesale prices in Queensland have fallen by around 23 percent since its internal competitive electricity market commenced.

- Gas prices for major industrial users fell 50 percent after deregulation of the Pilbara market in 1995, while gas distribution tariffs are set to fall 60 percent by the year 2000 in NSW (compared to 1997 prices).

- Rail freight rates for grain in Western Australia have fallen by 21 percent in real terms since deregulation in 1992-93, while rail freight rates for the Perth-Melbourne route fell 40 percent, and service quality and transit times improved, following the introduction of competition in 1995.

- Conveyancing fees in NSW fell 17 percent between 1994 and 1996, after the abolition of the legal profession’s monopoly and the removal of price scheduling and advertising restrictions, leading to an annual saving to consumers of at least $86 million.

- Prices for the outputs of government trading enterprises fell on average by 15 percent, and payments to governments doubled, in the four years to 1995-96, due partly to competition reforms.

- In Queensland, ten of the seventeen largest local councils have implemented two part tariffs for water, resulting in an average saving in water usage of 20 percent in the first year.

- Following a review of business licensing in NSW that found significant duplication and overlap, some 72 licenses have been repealed and more are being scrutinised. Among other changes, 44 categories have been collapsed into just three.

Details of these and other reform outcomes are contained in the Council’s 1997-98 Annual Report.