National Competition Council

Progress of National Competition Policy

A presentation by Graeme Samuel,
President, National Competition Council
to the Committee for Economic Development of Australia.

Sydney
21 July 1999

Progress of National Competition Policy

Setting the Scene

Australia is now in its fifth year of National Competition Policy (NCP), the most ambitious and comprehensive program of economic reform in the country's history. The NCP consists of a number of inter-governmental agreements between the Commonwealth, State and Territory governments. Each party recognised the benefits of co-ordinated policy development under the aegis of the Council of Australian Governments (COAG). The Agreements incorporate a range of infrastructure reforms – called 'related reforms' in electricity, gas, road transport and water, and a series of policy development processes, mainly in the areas of regulation review.

It is not surprising that the main part of the NCP program relates to infrastructure reforms given that infrastructure services play a vital role in the Australian economy. They are major business inputs and they are also essential services for customers. And the industries which supply these services are major resource users in their own right.
Consequently, the efficiency and competitiveness of these sectors is important not only for their direct customers but also for the broader business environment and the performance of the economy generally.

But historically, competition in these markets has been limited due to the size and scale of the investments required, the 'natural monopoly' characteristics of some infrastructure such as gas pipelines and electricity transmission grids, and the role which vertically-integrated utilities – generally government-owned – have traditionally played in supplying such services.

The NCP reform program is attacking this problem on three main fronts. First, governments have been breaking-up their utilities to separate those areas amenable to competition from those which are not, and then allowing other businesses to compete. Second, they are introducing national competitive markets in electricity and gas, and negotiating national reform agreements in other areas such as rail. And third, for cases where no national reform agenda exists, they have introduced a generic 'national access regime' – which is contained in Part IIIA of the Trade Practices Act (TPA) - or, in some case, complimentary state or territory access regimes, to allow businesses to get access to use the services of infrastructure owned by other businesses.

All governments recognised that the reform program would mean benefits for every part of Australia, but also that reform implementation should be tailored to the circumstances of each jurisdiction. The Agreements confer substantial discretion on each government in relation to the conduct of policy development processes, review and reform priorities, and the pace and timing of reform implementation.

The Council plays a significant role in assessing all governments progress with NCP. In accordance with the NCP agreements, the Council completed its first tranche assessment of governments' progress in June 1997.

The Council completed the second tranche assessment on 30 June 1999 where some $640 million in payments over the period to July 2000 is available for distribution (on per capita basis) to states and territories assessed as having met the NCP reform obligations. A further $800 million (approximately) is available the following financial year.

In the second tranche assessment, the Council adopted a 'no surprises' approach. In practice, this has meant that the Council has ensured that governments are aware at an early stage, of any areas where it is not clear that the NCP reform commitments have been (or will be) met and the approach it intends to take in its assessment.

Today, I intend to focus on three areas of NCP reforms that concern infrastructure:

- access to infrastructure;
- related reforms (electricity, gas, road transport and water); and
- rail reform.

Access to Infrastructure

While the infrastructure facilities themselves may, by necessity, be monopolies, the supply of products that use these facilities need not be. The National Access Regime which is contained in Part IIIA of the TPA addresses the situation where one body owns the monopoly infrastructure and provides the related services which may make it difficult for other businesses to use, or gain access to, the services of the natural monopoly infrastructure.

Because there has been a fair bit of publicity about Robe River's declaration application, let me quickly outline what it was about.

Robe River applied under Part IIIA of the TPA for a declaration of the Hamersley Iron's Pilbara rail track service.

When the Council receives a declaration application, it must first determine a number of threshold issues before assessing the application against the relevant criteria. One of the threshold issues is whether the service that is the subject of the application, is a 'service' for the purpose of Part IIIA. Section 44B of the TPA defines 'service' to include the use of an infrastructure facility such as a road or railway line. But 'service' does not include the use of a production process, except to the extent that it is an integral but subsidiary part of the service.

The Federal Court decided that the service to which Robe River sought access was not a service for the purposes of Part IIIA of the TPA. By way of an aside, I should point out that the decision was strictly confined to issues of *vertical integration* – that is to say whether the rail service constituted the use of a production process. The decision was not about issues of public or private ownership. Indeed the ownership of the infrastructure which is used to provide this service was not raised as an issue.

The decision has implications for all access arrangements. Firstly, it will encourage the

continued and expanding use of sector-specific access arrangements. These currently exist for telecommunications and airports, and the Federal Government is drafting a specific access regime for postal services. Secondly, the decision may encourage specific kinds of vertical integration. It offers an incentive for infrastructure owners to structure their operations in an integrated way so that they can argue that the structure of their process means that the definition of service in Part IIIA cannot be satisfied.

On the 19 July two of the original respondents to the court action, Hope Downs and the National Competition Council lodged separate notices of appeal against the decision. The National Competition Council has appealed the decision, because there are important issues of interpretation of Part IIIA of the Trade Practices Act that need to be resolved to provide greater certainty as to the application of the Access Regime. In lodging the appeal, the National Competition Council is not expressing any view on any recommendation that might be made by it in respect of the Robe River access application, if or when it were appropriate to make such a recommendation.

Related Reforms

Electricity reform

The electricity reforms are among the most ambitious in the NCP package and the electricity reform program is now well established. Structural reforms of electricity utilities is complete in New South Wales, Victoria, Queensland and the ACT. The National Electricity Market (NEM) is fully operational in New South Wales, Victoria, Queensland (operating a wholesale power market under the NEM rules), South Australia and the ACT. The construction of transmission links will confer full participation on Queensland (in the year 2000) and Tasmania (the Basslink is expected to be commissioned in the year 2002).

The operation of the NEM represents one of the most complex of the NCP reforms. To date competition in the wholesale power market has resulted in large benefits for contestable customers. For example, a survey (ACM 1998) of businesses able to select their own electricity supplier under the national market found an average reduction in electricity bills of 30.6 percent in New South Wales and 23.2 percent in Victoria.

Franchise customers have also received some price reduction benefits as part of the regulatory reforms. However, transaction costs have prevented the extension of full competition to retail customers. The development of effective retail competition will be a key issue for the further development of the electricity industry reforms.

Now that the NEM is operational, and competition in contestable services well established, some important issues are emerging. First, the Council will be seeking to ensure that exemptions from the operation of the National Electricity Code (NEC) are appropriately phased out. Second, questions are being raised about the efficacy of the NEC rules on the approval of regulated versus unregulated transmission inter-connectors. The National Electricity Code Administrator pricing review is examining this issue. The Council would be concerned by any government actions – outside the formal NEM processes – to impede construction of inter-connectors.

Third, there are suggestions that publicly-owned electricity generators have been competing on unfair terms with private generators. This is a competitive neutrality issue, however, no

complaint has been lodged with the appropriate competitive neutrality complaints authority.

Fourth, there have also been suggestions that states should revert to state-based markets and that interstate trade in electricity should be abandoned. The Council would have serious concerns over any moves to restrict the operation of the NEM in this way.

Gas reform

Gas reform has been one of the major success stories of NCP. Starting in 1992, a series of COAG gas reform agreements were developed to achieve free trade in gas throughout the nation and develop intra-field competition through:

- removing regulatory impediments to trade in gas;
- applying access arrangements to transmission and distribution infrastructure; and
- facilitating the construction of new transmission links between gas fields and markets.

Incorporating the gas reform into the NCP provided an impetus to gas reform. Work undertaken by the national Gas Reform Task Force and its successor, the Gas Reform Implementation Group under the auspices of NCP helped to ensure that reform progressed on a nationally co-ordinated basis, rather than piecemeal state-by-state approaches. Further, the risk of declaration of gas transport services under the new Part IIIA of the TPA helped facilitate agreement between governments and industry on the path to reform.

Benefits arising from the gas reform include a reduction of gas prices of 50 percent in Western Australia, for major industrial users, after deregulation of the Pilbara market in 1995.

While there are some remaining issues such as retail competition, intra-field competition and the finalisation of access arrangements in a few states, gas reform in Australia is essentially complete.

Road Transport reform

The 1995 NCP agreements created obligations on jurisdictions but did not establish a clear road transport reform agenda. After a slow start, governments are turning their attention to national road transport reform. Recently, governments endorsed a 19 point reform package brought forward by the Australian Transport Council (ATC) in December 1998. The package includes a nationally consistent regulatory framework for heavy vehicle registration, driver licensing, heavy vehicle mass and loading restrictions, commercial driver fatigue management and the national exchange of vehicle and driver information.

In view of the heavy dependence of Australians on an efficient road transport system, the Council has set itself the objective of using the NCP process to encourage governments to implement the regulatory framework as quickly as can reasonably be expected.

The National Road Transport Commission is continuing to develop the national reform package in conjunction with governments. Further reform elements will be made available for implementation following their support by the ATC. In this interactive and evolving way, newly available reforms and the remainder of the current reforms that have been endorsed by COAG, have been added to the 19 point reform package.

Water reform

Water reform has been a major focus of governments' NCP implementation activity over the past two years. The NCP water reform agenda is now well under way. The noticeable impact of this can be seen in pricing reform across the Australian metropolitan water industry. For

example, pricing reform has contributed to an 18 per cent reduction in water prices to Victorians, a 20 per cent decline in water use in Brisbane and real water costs for businesses in Western Australia falling by almost 50 per cent between 1992–3 and 1997–8.

Water reform highlights the multifaceted nature of NCP. The water reform package encompasses urban and rural water and wastewater industries and includes both economic and ecological objectives. Urban water is now priced to encourage efficient water service provision and use. Residential and commercial consumers will pay only for the water they use. Providers are more accountable for the quality and cost of water and sewerage services. The water reform package acknowledges the environment as a legitimate user of water. The introduction of tradable water entitlements, separate from land rights, provides the scope for water to be reallocated to its highest value use. For example, it allows producers to purchase entitlements from current users rather than obtain water by increasing diversions from already stressed water systems.

As with any public policy of this magnitude, implementing the water reform package has not been without its difficulties. The second tranche assessment identified some problems with water reform. These include slippages in terms of establishing institutional arrangements; water allocation and trade arrangements, and new investments in rural water schemes that is both economically viable and ecologically sustainable.

The Council has worked with jurisdictions to overcome these problems and develop an assessment process that is co-operative, sensible and fair.

That concludes the related reforms. Before I wrap up, a few comments on rail reform.

Rail reform

While the NCP agreements include specific arrangements to cover reforms in electricity, gas, road transport and water which I have already addressed; an obvious omission from this list is rail services.

Without a national rail reform agreement, the business community, in its attempts to gain improved service quality and lower prices, has had to rely on the general provisions of the Competition Principles Agreement and, in particular, the National Access Regime included in Part IIIA of the TPA. But Access arrangements alone cannot address all the problems.

In 1997, governments signed a rail agreement that recognised that there was a clear and urgent need to reform interstate rail. An important part of the agreement that is relevant to the work of the Council is the access arrangements. The rail agreement includes arrangements which provide Australia-wide track access as a single service to rail operators, thereby avoiding the need to seek separate access in each state.

At the same time, states are developing their own rail access regimes. To date, several states have applied to the Council to have these regimes certified as effective. The state regimes cover all rail services, not just those applying to interstate freight. However, in assessing these state regimes, the Council is required to consider what impact the regime would have on rail services operating across state borders.

Since the 1997 inter-governmental agreement, much groundwork has been done to enable interstate rail access arrangements to be implemented. Obviously, a co-ordinated approach is superior to state-by-state arrangements. Therefore, in exercising its responsibility to assess state regimes, the Council is aware of the need to link closely with the National process. This means that the Council's involvement will focus on ensuring that state regimes facilitate, rather than frustrate, the National process.

Following the introduction of competition in 1995, rail freight rates in Western Australia have fallen by 42 percent in real terms since 1991- 92, while rail freight rates for the Perth-Melbourne route fell 40 percent, and service quality and transit times have improved.

Concluding Remarks

While reform is generally advancing in the right direction in many infrastructure sectors, the pace of reform has not kept up with the timetables originally established under the NCP agreements. It is of course better to get reform right rather than to get it fast. But unnecessary delays to reform mean unnecessary delays to the commencement of the flow of benefits to be had from infrastructure reform.

As I have already mentioned, there is growing evidence that infrastructure reforms will bring – and are already bringing – important benefits for Australians.