National Competition Policy

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NATIONAL COMPETITION POLICY REVIEW

Chairman: Prof Frederick G Hilmer
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25 August 1993

Heads of Australian Governments

In October 1992 the Prime Minister asked us to undertake an independent Inquiry into a national competition policy, following the agreement by Australian Governments on the need for such a policy.

We take pleasure in presenting our report. It reflects written submissions from nearly 150 organisations and individuals from around Australia as well as consultations with senior representatives of all Australian Governments and many industry, professional, trade union, consumer and other organisations.

The Inquiry found strong and widespread community support for implementing an effective national competition policy. There is a significant awareness of the opportunities such a policy offers Australia to improve our international competitiveness and hence living standards.

Governments, both individually and together, have made important progress along the path of making Australia a more competitive economy. The Committee sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity and rail. But we have taken a bolder stance because of the urgency of the reform task and the belief that precedents should be considered as steps forward, rather than as desirable models in and of themselves.

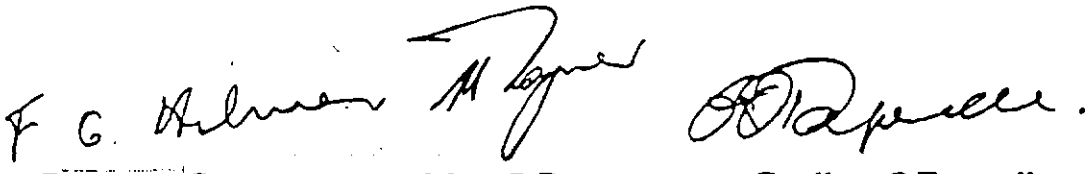
LOCKED BAG 32, QUEEN VICTORIA TERRACE, PARKES ACT 2600

Australia is increasingly a single integrated market, and this should be reflected in our competition policy, as it is in other important areas of economic and commercial policy. We consider that our proposals are a logical and necessary progression from the national reforms recently implemented in other areas, and that governments should give them early attention in the national interest.

Our report proposes that a national competition policy comprise a combination of laws, principles and processes, as well as two key institutions. Implementation of our proposals would involve a substantial role for all Australian Governments, working together to achieve common national objectives.

We commend our report for your consideration.

Yours sincerely



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Mark R Rayner (Member)

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Premier of New South Wales

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Premier of Tasmania

The Hon R Follett, MLA
Chief Minister of the
Australian Capital Territory

The Hon M B Perron, MLA
Chief Minister of the
Northern Territory

Preface

This Report recommends implementation of a national competition policy for Australia. The Committee of Inquiry was established in October 1992 by the Prime Minister following agreement by all Australian governments on the need for a national policy and its basic principles. It is recognised that Australia, for all practical purposes, is now a single integrated market, increasingly exposed to domestic and international competition. A national competition policy aims to promote and maintain competitive forces to increase efficiency and community welfare, while recognising other social goals.

Competition policy is a broad topic comprising rules governing the conduct of firms such as those in Part IV of the Trade Practices Act, and a wide range of legislation, policy and government action. Competition policy affects sectors of the economy in different ways, depending upon the nature and level of competition existing in each sector. To deal with this complexity, the Committee concentrated on developing a framework of principles, processes and institutional structures which would be sufficiently flexible to deal with the scope of the subject and different sectors of the economy. The Committee has not sought to develop detailed policy prescriptions for each sector of the economy, believing that this is an inappropriate approach for developing a national policy.

The Committee is confident that implementation of its proposals provides an opportunity to consolidate the many reforms already undertaken by governments over the last decade, and to advance and accelerate this process. While most areas of the economy will be affected, there will be greatest impact on sectors previously sheltered from competition such as major infrastructure industries and some areas of agricultural marketing and the professions.

The report has been organised for two kinds of readers. Those wishing a full discussion of the background and recommendations are urged to read the entire Report. Those readers wishing to cover only the central features of the Committee's findings and proposals will probably find that the Executive Overview and Chapters 1, 2, 8, 14 and 15 will suffice. These Chapters provide overviews of the

substantive issues addressed in the Report and the proposed implementation arrangements.

The Committee would like to thank the many individuals and organisations who have made submissions to the Inquiry, and those who have met with the Committee and Secretariat to assist our understanding of the many issues we have considered.

The Committee would also like to thank the Secretariat for the high quality of its assistance and support throughout the Inquiry and in the preparation of this Report. This group was led by Warrick Smith, and included Roger Brake, Daryl Quinlivan, Michael Warlters and Kirsten Embery. Kerrie Ebner, Bim Engler and Orginia Charteris provided administrative support. Eugene Goyne, Jane Lye and Andrew McPadden also assisted the group during the course of the Inquiry.

Table of Contents

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Executive Overview

Australia is facing major challenges in reforming its economy to enhance national living standards and opportunities. There is the challenge of improving productivity, not only in producing more with less and deploying scarce assets wisely, but also in becoming better at making and exploiting new discoveries, whether in technology, resources, fashion or ideas. A possibly more difficult challenge is to develop in a way that creates new jobs and growth rather than see the economy shrinking to an efficient but diminishing core of activity.

Coping with these challenges is an enormous task for any country, and Australia is not alone in finding the process of reform testing and early benefits elusive, particularly when world economic growth is negligible. However, Australia faces an additional complexity in tackling these challenges, as most reforms require action by up to nine governments. This is particularly true in competition policy, an area central to micro-economic reform which aims at improvements at the front line of the economy.

A. TOWARDS A NATIONAL COMPETITION POLICY

As the Prime Minister has observed, "the engine which drives efficiency is free and open competition".[1] Competition is also a positive force that assists economic growth and job creation. It has triggered initiative and discovery in fields ranging from the invention of the telephone to the opening of new retail stores and small manufacturing operations. In fact, it is these developments in smaller firms, prompted by the belief of these firms in their ability to compete, that are the main source of both new jobs and value-added exports.[2]

The benefits of fostering more competitive markets are being increasingly recognised by governments around Australia, and indeed around the world. Within Australia, all levels of government have made important reforms to enhance competition. Trade barriers

1 The Hon PJ Keating MP, *One Nation* (Statement by the Prime Minister, 26 Feb 1992) at 15.

2 See Australian Manufacturing Council, *The Challenge of Leadership: Australia's High Value-Added Manufacturing Exporters* (1993).

have been lowered to increase international competition, and restrictions on competition within Australia have been relaxed in sectors as diverse as telecommunications, aviation, egg marketing and conveyancing. Consumers are already obtaining substantial benefits through these reforms, and businesses which rely on these inputs are better placed to compete successfully in international markets. Reforms of these kinds also foster innovation and make the economy more flexible, improving its capacity to respond to external shocks and changing market opportunities.

Competition Policy

Competition policy is not about the pursuit of competition *per se*. Rather, it seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as the sanctioning of anti-competitive arrangements on public benefit grounds.

Australian competition policy is sometimes seen as solely comprising the provisions of Part IV of the Commonwealth *Trade Practices Act 1974* (TPA). While laws of that kind are an important part of competition policy, the relevant field of policy interest is much wider. In its broadest sense, competition policy encompasses all policy dealing with the extent and nature of competition in the economy.[3] It permeates a large body of legislation and government action that influences permissible competitive behaviour by firms, the capacity of firms to contest particular economic activities and differences in regulatory regimes faced by different firms competing in the one market.

[3] Policy governing the extent of competition from international sources — an important part of trade policy — is treated as distinct from competition policy, notwithstanding its similar effects in terms of competition in the domestic market. Policy governing the protection of consumers as a group (such as provisions like Part V of the *Trade Practices Act 1974*) is also treated as distinct from competition policy, notwithstanding that both policies benefit consumers and some consumer protection provisions improve the efficiency of markets. The Committee's understanding of competition policy is consistent with the emphasis of its terms of reference and the overwhelming majority of submissions received by the Inquiry.

The Committee has considered competition policy in terms of six specific elements, each of which is supported by laws, policy and/or government action as illustrated in Box 1.

Box 1: Elements of Competition Policy

Policy Element	Example
1. Limiting anti-competitive conduct of firms	Competitive conduct rules of Part IV of the Trade Practices Act
2. Reforming regulation which unjustifiably restricts competition	Deregulation of domestic aviation, egg marketing and telecommunications
3. Reforming the structure of public monopolies to facilitate competition	Proposed restructuring of energy utilities in several States
4. Providing third-party access to certain facilities that are essential for competition	Access arrangements for the telecommunications network
5. Restraining monopoly pricing behaviour	Prices surveillance by Prices Surveillance Authority
6. Fostering "competitive neutrality" between government & private businesses when they compete	Requirements for government businesses to make tax-equivalent payments

The Need for a National Competition Policy

The imperative for developing a national competition policy rests on three main factors.

First, there is increasing acknowledgment that Australia is for all practical purposes a single integrated market. The economic significance of State and Territory boundaries is diminishing rapidly as advances in transport and communications permit even the smallest firms to trade around the nation. The increasing national orientation of commercial life has been recognised by a series of significant cooperative ventures by Australian Governments. The 1990s have already seen national progress on reforms including the National Rail Corporation, road transport regulation, the

Corporations Law, the mutual recognition of product standards and occupational licensing, and the regulation of non-bank financial institutions. There are also moves towards greater interstate trade in electricity and gas. Business and the community generally are impatient for much more rapid progress by governments in reforming our infrastructure and regulatory systems.

Second, while trade policy reforms have markedly increased the competitiveness of the internationally traded sector, many goods and services provided by public utilities, professions and some areas of agriculture are sheltered from international and indeed domestic competition. In this regard, recent micro-economic reforms have highlighted that an important part of Australian competition policy — the Trade Practices Act — remains limited in its application to these sectors, with coverage depending on ownership or corporate form rather than considerations of community welfare.

Third, the domestic pro-competitive reforms implemented to date have all been progressed on a sector-by-sector basis, without the benefit of a broader policy framework or process. Reforms undertaken in this way are typically more difficult to achieve, with the ground rules — including the respective roles of Commonwealth, State and Territory Governments — having to be negotiated on a case-by-case basis. A national competition policy presents opportunities to progress reform more broadly, to promote nationally consistent approaches and to avoid the costs of establishing diverse industry-specific and sub-national regulatory arrangements.

Considerations of these kinds led Commonwealth, State and Territory Governments to agree on the need to develop a national competition policy which would give effect to the principles set out below:

(a) *No participant in the market should be able to engage in anti-competitive conduct against the public interest;*

(b) *As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;*

(c) *Conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;*

(d) *Any changes in the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:*

(i) *to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition;*

(ii) *in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.*

Agreement on these principles, and the support of all Australian Governments for the establishment of this Inquiry in October 1992, represents a significant step toward an effective national competition policy. Submissions to this Inquiry showed strong and widespread community support for implementing such a policy.

The Committee's Approach

The Committee saw its task as proposing the most effective form, content and implementation approach for a national competition policy that will support an open, integrated domestic market for goods and services.

It approached this task at a broad policy level, looking for common themes and issues rather than developing detailed prescriptions for each individual sector of the economy. At the same time, the Committee considers that its proposals are flexible enough to address all of the main issues presented in submissions.

The Committee also sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity, rail and gas. But the Committee is taking a bolder stance because of the urgency of the reform task and the belief that precedents should be considered as steps towards more effective national reform rather than as desirable models in and of themselves.

The Inquiry Process

The Committee took account of a wide spectrum of community views, with written submissions received from nearly 150 organisations and interests.[4] In October 1992 the Committee invited written submissions from interested persons and organisations through advertisements in the national and major regional newspapers. In February 1993 the Committee published an issues paper to elicit further comments on the issues under consideration. Submissions were received from major business, industry, professional and consumer organisations, trade unions, small and large businesses and private individuals, as well as Australian Governments.

The Committee met with Premiers, Chief Ministers, Ministers and senior officials of each State and Territory and senior representatives of several Commonwealth Departments and agencies. The Committee also consulted with a number of business, industry, professional and consumer organisations.

In accordance with its terms of reference, the Committee took account of overseas approaches where they were thought to offer lessons for Australia. Particular attention was given to other countries with federal systems of government and to the European Community. New Zealand approaches were of particular interest, not only because of its similar competition laws and the desirability of harmonising business laws in accordance with the Australia/New Zealand Closer Economic Relations Trade Agreement, but also because of New Zealand's recent experiences in pro-competitive reforms.

In its initial terms of reference the Inquiry was to have reported in May 1993. However, the Committee's reporting date was extended until August 1993 to permit further consultations, particularly with State and Territory governments.[5]

4 A list of submissions is set out in Annex B.

5 The Hon P J Keating MP, Media Release, 24 May 1993 (62/93).

B. KEY FINDINGS & RECOMMENDATIONS

The Committee has recommended a national competition policy covering each of the six main elements highlighted in Box 1. These elements, and the Committee's findings and recommendations, are dealt with in three parts.

- **Part I** deals with the generally applicable conduct rules, including the content of those rules, their sphere of application and aspects of the enforcement regime. It argues that a slightly modified version of the rules currently contained in Part IV of the Trade Practices Act should apply universally to all business activity in Australia.

- **Part II** outlines specific policy proposals and mechanisms for the five additional policy elements the Committee proposes should form part of a national competition policy. These include principles and processes governing the reform of regulatory restrictions on competition, the structural reform of public monopolies, and competitive neutrality between government and private businesses; a general access regime; and a more focussed prices oversight mechanism.

- **Part III** outlines issues associated with the implementation of the Committee's policy proposals, including institutional, legal, transitional and resource matters. Two new institutions are proposed: a National Competition Council, formed jointly by Australian Governments to assist in progressing cooperative reforms, and an Australian Competition Commission, which would administer the competitive conduct rules and some other aspects of the new policy.

1. Competitive Conduct Rules

Every modern market economy has a set of rules designed to ensure that the competitive process is not undermined by the anti-competitive behaviour of firms, whether acting collusively or individually. Typically, these rules prohibit agreements or arrangements that increase the market power of firms and prohibit firms which individually possess substantial market power from using that power in an anti-competitive way. In Australia these rules are contained in Part IV of the Commonwealth *Trade Practices Act* 1974.

The Committee's work uncovered two major misconceptions about the TPA, which ultimately proved pivotal to its recommendations.

The first is the extent to which particular entities or activities are exempt from the Act. While the Committee found that many of the current exemptions from the Act are not justified on considered policy grounds, there are no general exemptions favouring government businesses, the professions or agricultural marketing authorities, and many of these groups are already subject to the Act to some degree or in some circumstances.

The second misconception relates to the impact of applying the Act to currently excluded sectors. Application of the TPA would have only limited impact on many sectors that are partially excluded from its reach. Important as it is in protecting competition, the Act only prohibits certain kinds of voluntary conduct that may restrict competition, and will generally have little or no impact on matters such as market structure or restrictions imposed by laws or other government policies. For this reason, the Committee recommends other means for addressing these competition issues, which respond to the main concerns raised in submissions. The Committee's proposals in these areas are outlined in Section B.

The Committee reviewed the provisions of the Act in some detail and for the most part found them to be operating satisfactorily, to be broadly consistent with overseas approaches, and to be appropriate for application to currently excluded sectors without substantial revision. The most pressing issue is to ensure that unjustified gaps in their application are filled in a way that promotes a nationally consistent legal framework for business activity.

Content of the Rules

The rules contained in Part IV of the Trade Practices Act are intended to protect the competitive process by prohibiting anti-competitive agreements, the misuse of market power, resale price maintenance and certain mergers or acquisitions. There is also a specific prohibition on anti-competitive price discrimination.

The Committee reviewed the current rules in light of submissions received, overseas approaches and any possible new issues that might

arise in applying the rules more broadly in the Australian economy. The Committee is mindful that unnecessary tinkering with the current rules could create uncertainty and delay extending the application of the rules, which is seen as the more pressing objective. Accordingly, the Committee has adopted a deliberate policy of limiting proposed changes to those areas where the current rules were found to be clearly deficient from the standpoint of a national competition policy. The Committee's main recommended changes to the current rules are:

- strengthening the prohibition on price fixing arrangements by removing the distinction between goods and services, which potentially allows agreements relating to services to be authorised, thus sending an unambiguous signal about the undesirability of collusive price-fixing;

- relaxing the prohibition on third line forcing by requiring that it substantially lessen competition, thus bringing it into line with the Act's treatment of other forms of exclusive dealing;

- permitting authorisation of resale price maintenance where it can be demonstrated to offer net public benefits;

- repealing the specific prohibition on price discrimination, with any anti-competitive conduct in this area addressed under the prohibition on the misuse of market power; and

- removing unjustified distinctions between goods and services in the Act.

Exemptions from the General Conduct Rules

Gaps in coverage of market conduct rules can allow excluded firms to engage in anti-competitive conduct with impunity, impairing efficiency and equity. At the same time, there may be cases where application of the market conduct rules should be suspended or adjusted on public interest grounds, primarily where the benefits of the conduct in question are found to outweigh the anti-competitive detriments. The current Australian regime involves the interaction of up to seven often overlapping exemption mechanisms, many of which are unrelated to any question of public benefit and can fragment application of the rules according to State borders. The Committee

sees a need for substantial reform in this area, with fewer and more rigorous and transparent exemption processes.

The Committee concluded that the general conduct rules of a national competition policy should, in principle, apply to all business activity in Australia, with exemptions for any particular conduct only permitted when a clear public benefit has been demonstrated through an appropriate and transparent process. Indeed, this much has already been agreed by Australian Governments. The Committee's findings on each of the current exemption processes are summarised below.

- *Authorisation By An Independent Body*

The Committee concludes that the primary basis for permitting exemptions from the rules should be an authorisation process of the kind currently administered by the Trade Practices Commission. The proposed successor to that body — the Australian Competition Commission — should be directed to give primacy to economic efficiency considerations in determining questions of public benefit, and the new regime of user-pays fees should be reviewed.

- *Specific Exemptions Set Out In the TPA*

The Committee sees a continuing role for some specific exemptions in the Act itself. The current limited exemptions for *labour agreements, standards, restrictive covenants, export contracts* and *consumer boycotts* should be retained. The current exemption for certain *intellectual property* matters raises issues which warrant a separate review by appropriate experts. The current exemption for *overseas shipping* is considered a clear candidate for sweeping reform, although the Committee has not made comprehensive recommendations in light of a separate Inquiry on this matter.

- *Exemption By Regulations Under the TPA*

The current provision permitting exemption by regulation of certain conduct of *primary commodity marketing bodies, Commonwealth businesses* and *contracts or conduct engaged in pursuant to international agreements* is not currently in use. This provision should be replaced by a regulation power unlimited as to subject matter but strictly limited as to time. The primary role of such a

mechanism would be to provide urgent protection pending the consideration by Parliaments of alternative legislative proposals.

- *Exemption By State or Territory Statute or Regulations*

The significance of the current provision which permits State or Territory statutes or regulations to specifically authorise or approve conduct otherwise in breach of the Act (subject to a power for the Commonwealth to over-ride such exemptions) was found to be misunderstood in many quarters. Although there were suggestions that removal of this provision would of itself see a large range of anti-competitive regulations being over-ridden, particularly in agricultural marketing and professional regulation, this is not borne out by a close analysis of the State and Territory laws in question.

The overwhelming majority of laws examined by the Committee in areas such as these were found to achieve their anti-competitive effect in a way that did not involve conduct that would otherwise have contravened the Act, making the current exemption provision irrelevant to their future operation. Some of the subtleties in this area are illustrated in Box 2.

In the Committee's view, the current exemption mechanism in the Act permitting State and Territory Acts to specifically authorise conduct that would otherwise contravene the Act is inappropriate. It discourages the development of nationally-consistent rules and is not readily transparent. No future exemptions of this kind should be permitted, and all existing exemptions should be deemed to expire at the end of three years.

- *Exemption By Other Commonwealth Statutes or Regulations*

The current provision permitting other Commonwealth statutes and regulations to specifically authorise or approve conduct otherwise in breach of the Act was also subject to misunderstanding in some quarters. However, the significance of the Commonwealth provision differs from the State and Territory provisions in two respects.

Box 2 : Government Regulation & the TPA

The Trade Practices Act operates by prohibiting certain *conduct* by market participants, generally requiring a degree of collusion or anti-competitive purpose. It does not prohibit anti-competitive *outcomes* per se. Three situations in the price fixing area can be contrasted:

(a) **A group of competing firms enter an agreement to fix prices**

Prima facie, arrangements of this kind are prohibited by the TPA as a contract, arrangement or understanding between competitors with the effect of fixing, controlling or maintaining price.

(b) **The same firms engage in the same conduct as (a), but with a statute or regulation specifically authorising them to agree on prices**

Prima facie, there is still conduct prohibited by the Act, although the current Act permits Commonwealth, State and Territory Governments to effectively immunise such conduct.

(c) **Rather than authorising a private agreement between firms, a statute or regulation provides that the goods in question shall only be sold at a price declared by a Minister or a marketing board**

In this case, the same result (ie, a fixed price) is achieved without the need for firms to engage in conduct of the kind prohibited by the TPA. Statutes and regulations of this kind are unaffected by the TPA.

Comment

The different status of situations (b) and (c) is not merely one of legal form. In situation (c), a governmental authority is directly responsible for particular prices, and the extent of benefit afforded the firms in question will be apparent through the legislative or regulation-making process. Similarly, the firms in question have no choice but to comply with the regulation. In situation (b), in contrast, governments have essentially delegated responsibility to the firms in question, and the reasonableness or otherwise of their pricing conduct is not subject to the same degree of public scrutiny.

First, unlike State and Territory laws, this provision does not have the potential to impede national consistency. Second, a provision of this kind provides greater certainty as to the interaction of Commonwealth statutes — in the absence of such a provision there may be difficult questions of interpretation to determine whether a later Commonwealth Act had impliedly repealed part of the TPA to the extent of any inconsistency. This issue does not arise in relation to State and Territory laws, where the TPA would override even subsequent State and Territory laws.

The provision should be amended to improve the transparency of any specific exemptions: exemption under other laws should be limited to statutes, rather than regulations, and the exempting provision should be required to state specifically that its purpose is to authorise conduct for the purposes of the TPA.

- *Shield of the Crown Doctrine*

This doctrine provides that a statute will only be found to bind the Crown by express words or necessary implication. Since 1977 the Trade Practices Act has expressly bound the Crown in right of the *Commonwealth* in so far as it engages in business. This provision should be amended to remove any doubts as to the application of the Act to commercial transactions between Commonwealth businesses in competition with private firms.

The Act's silence on the question of whether it is intended to bind the Crown in right of the *States and Territories* led it to be interpreted as not binding these entities. Whether or not a particular State or Territory business is entitled to take advantage of the immunity is often a difficult question of statutory interpretation: certainly, there is no blanket exemption for all such businesses. The High Court has recently questioned the relevance of the doctrine to contemporary circumstances, and several submissions pointed to the uncertainties for government businesses in this area. This uncertainty should be removed by amending the TPA to ensure that the Act applies to State and Territory businesses to the same extent it applies to Commonwealth businesses.

- *Constitutional Limitations*

The final gap in application of the Act flows from the constitutional limitations on the Commonwealth Parliament. As currently drafted, a business may escape the operation of the Act by virtue of its non-corporate status unless it engages in interstate or overseas trade or commerce. Exemptions of this kind cannot be justified in policy terms and have no place in a national competition policy.

Remedies and Enforcement

The Committee reviewed the current remedies under the TPA and considers that they are appropriate for the general conduct rules of a national competition policy. The Committee also reviewed broader issues associated with the enforcement of the Act. Opportunities to improve courts' capacity to deal with economic issues were considered and should be pursued further. At the same time, these are not considered to be of sufficient importance to warrant delay in implementation of a national policy.

II. Additional Policy Elements

Rules of the kind contained in the TPA do not address the full range of issues associated with building a more competitive economy, particularly when impediments to that goal arise through other government regulation or government ownership.

While application of the Act has many benefits, more is required if effective competition is to be fostered in many sectors of the economy. Regulatory restrictions on competition may need to be removed or modified. The structure of public monopolies may need to be reformed. Competitors may need to be assured of access to certain facilities that cannot be duplicated economically. Concerns over monopoly pricing may require attention. And the special advantages enjoyed by some government businesses when competing with private firms may need to be addressed. An effective national competition policy requires measures to respond to each of these issues.

Policy measures addressing these issues have important implications for governments, as it is their laws and businesses that will be affected most directly. As well as concerns over the prerogatives of governments — always a sensitive matter in a federal system — there are concerns over the potential impact on profits from government monopolies, and on the delivery of certain non-commercial functions by government businesses.

The Committee was cognisant of these concerns and sensitivities in framing its recommendations, but has balanced these against the important national interests involved. Where possible, the Committee has focussed on cooperative approaches, based on principles and processes implemented by individual governments,

rather than proposing national laws. Where national laws are considered essential, the Committee recommends that the interests of the States and Territories be protected through various safeguards, the most important of which is the establishment of a **National Competition Council**. This body would be established jointly between the Commonwealth, State and Territory Governments, and would play a key role in each of the additional policy areas.

The Committee's recommendations in respect of each of the five additional policy elements are summarised below.

Regulatory Restrictions on Competition

The greatest impediment to enhanced competition in many key sectors of the economy are the restrictions imposed through government regulation — whether in the form of statutes or subordinate legislation — or government ownership. Examples include legislated monopolies for public utilities, statutory marketing arrangements for many agricultural products and licensing arrangements for various occupations, businesses and professions.

Compliance by a business (private or public) with government regulation is not prohibited by the TPA, however anti-competitive the consequences. Nor is imposition of the regulation. Application of the Act will not be sufficient to overcome regulatory arrangements that establish monopolies, provide for the compulsory acquisition of crops, regulate prices, restrict the performance of certain activities to licensed occupations or a host of other regulatory restrictions on competition. Even if all exemptions from the Act were eliminated — including the potential for Commonwealth, State or Territory laws to authorise certain conduct[6] — these regulatory arrangements would be disturbed little if at all.

If Australia is to take competition and competition policy seriously, a new mechanism is required to ensure that regulatory restrictions on competition do not exceed what is justified in the public interest. The Committee recommends that all Australian governments adopt a set of principles aimed at ensuring that statutes or regulations do not restrict competition unless the restriction is justified in the public interest. This would involve:

6 See s.51(1) of the Act, discussed in Chapter 6 of the Report.

- acceptance of the principle that any restriction on competition must be clearly demonstrated to be in the public interest;

- new regulatory proposals being subject to increased scrutiny, with a requirement that any significant restrictions on competition lapse within a period of no more than 5 years unless re-enacted after further scrutiny through a public review process;

- existing regulations imposing a significant restriction on competition being subject to systematic review to determine if they conform with the first principle, and thereafter lapsing within no more than 5 years unless re-enacted after scrutiny through a further review process; and

- reviews of regulations taking an economy-wide perspective to the extent practicable.

While implementation of these principles is left largely to individual governments, the National Competition Council could be given references to undertake and/or coordinate nation-wide reviews in specified areas and to provide guidance on any transitional issues involved. The Council could also assist governments in developing more detailed principles covering individual sectors.

Structural Reform of Public Monopolies

The removal of regulatory restrictions on competition may not be sufficient to foster effective competition in sectors currently dominated by public monopolies. Recent work by the OECD has highlighted the importance of creating competitive market and industry structures if effective competition is to emerge.[7] As governments have recognised through reforms in place or under consideration in a number of sectors, structural reform of existing public monopolies may be required. The TPA does not address concerns of this kind and an effective competition policy must include a mechanism that does so.

The Committee recommends that all Australian Governments adopt a set of principles aimed at ensuring that, as part of reforms to

7 OECD, *Regulatory Reform, Privatisation & Competition Policy*, (1992) at 43.

introduce competition to a market traditionally dominated by a public monopoly, the public monopoly be subject to appropriate restructuring. The principles deal with:

- the separation of regulatory and commercial functions of public monopolies;
- the separation of natural monopoly and potentially competitive activities; and
- the separation of potentially competitive activities into a number of smaller, independent business units.

While the implementation of these principles is left largely to individual governments, the National Competition Council could be given references to advise governments when required.

Structural reforms of these kinds are even more important if a substantial monopoly is to be privatised. While the Committee also favours cooperative approaches in this area, it recommends that a process be established to deal with the unlikely event that a government privatises a substantial monopoly without appropriate restructuring. The process would involve an inquiry by the National Competition Council that could be triggered by any government before a privatisation was effected or, if no sufficient notice of the intended privatisation had been given, within a reasonable time after the privatisation. The Council would report to Australian Governments recommending what action, if any, should be taken. In an extreme case, it may be appropriate for specific legislation to be passed, possibly by the Commonwealth Parliament, to prevent privatisation of the monopoly or to effect a divestiture of the privatised monopoly.

Access to Essential Facilities

Introducing competition in some markets requires that competitors be assured of access to certain facilities that cannot be duplicated economically — referred to as "essential facilities". Effective competition in electricity generation and rail services, for example, will require firms to have access to the electricity transmission grid and rail tracks.

While the misuse of market power provision of the Act can sometimes apply in these situations, submissions to this Inquiry confirmed the Committee's own assessment that something more is required to meet the needs of an effective competition policy.

The Committee recommends that a new legal regime be established under which firms could in certain circumstances be given a right of access to specified "essential facilities" on fair and reasonable terms. The regime would operate by specific declaration applying to designated facilities under a general law, provide safeguards to the owner of the facility and to users, and have the flexibility to deal with access issues across industry sectors and facilities. Key features of the proposed regime include:

- the regime could only be applied to a facility without the owner's consent if declaration was recommended by the National Competition Council after a public inquiry;

- the access declaration would specify pricing principles for the individual facility; thereafter, actual access prices would be determined through negotiation between the parties and, if need be, through binding arbitration;

- the access declaration would specify any other terms and conditions relating to access designed to protect the legitimate interests of the owner of the facility; and

- all access agreements would be required to be placed on a public register; if additional safeguards were considered necessary to protect the competitive process they could be specified as part of the declaration process.

The National Competition Council would play a central role in advising on whether access rights should be created and, if so, on what terms and conditions. The regime would only be applied to the limited category of cases where access to the facility was essential to permit effective competition and the declaration was in the public interest having regard to the significance of the industry to the national economy and the expected impact of effective competition in that industry on national competitiveness. An access right under the proposed regime could not be created without the recommendation of the Council, although the designated Minister would have the

discretion to decline to declare access notwithstanding the recommendation of the Council.

Monopoly Pricing

In markets characterised by workable competition, charging prices above long-run average full costs will not be possible over a sustained period, as above-commercial returns will attract new market participants or lead consumers to choose a rival supplier or substitute product. Where the conditions for effective competition are absent — such as where firms have a legislated or natural monopoly or the market is otherwise poorly contestable — firms may be able to charge prices above efficient levels for periods beyond a time when a competitive response might reasonably be expected. Such "monopoly pricing" is detrimental to consumers and to the community as a whole. The TPA does not address this issue, and the Prices Surveillance Act has a limited reach.

The Committee considers the primary response of competition policy in these markets should be to increase competitive pressures, including by removing regulatory restrictions, restructuring public monopolies and, if need be, providing third party access rights. Where measures of this kind are not practical or sufficient, some form of price-based response may be appropriate.

The Committee recommends that a national competition policy should include a carefully targeted prices monitoring and surveillance process to apply in such cases. The regime would operate by declaration of a designated Commonwealth Minister and include the following features:

- a firm could only be subject to the prices oversight mechanism without its consent if the National Competition Council has recommended declaration after a public inquiry into the competitive conditions in the market *and* it was found to have substantial market power in a substantial market in Australia;

- powers would be limited to prices oversight or monitoring — there would be no price control power;

- declarations would lapse automatically after a period of no more than three years unless renewed following a further public inquiry; and

- existing declarations should lapse within two years unless renewed through the new declaration process.

Pricing issues affecting State and Territory government businesses would be dealt with according to the following principles:

- governments should generally progress pricing reform of their businesses through cooperative processes aimed at improving transparency and fostering appropriate and consistent approaches. Governments might consider the establishment of expert pricing bodies like the NSW Government Pricing Tribunal;

- governments could agree, on a case-by-case basis, to subject their businesses with substantial market power to the national prices oversight mechanism; and

- application of the national prices oversight mechanism to State and Territory government businesses should generally be by consent; however, consent may be waived if a government has failed to progress effective pricing reform in an area with a significant impact on interstate or international trade.

Competitive Neutrality

Moves to increase the efficiency of government businesses through commercialisation and the introduction of competition have raised a new set of issues for competition policy, particularly where those businesses continue to enjoy net advantages vis-a-vis private competitors. As competition of this kind is likely to increase over the next decade, there is a growing need to find some mechanism to deal with "competitive neutrality" concerns. While removal of any exemption from the TPA is part of this process, application of the Act will not of itself address all concerns over the cost advantages and pricing policies of some government businesses.

The Committee recommends that Commonwealth, State and Territory Governments adopt a set of principles aimed at ensuring government-owned businesses comply with certain competitive

neutrality requirements when competing with private firms. The principles distinguish between government businesses competing in their traditional markets which are now being exposed to competition, and competition in new markets. While the argument for neutralising any net competitive advantage is the same in both situations, a transitional period should be permitted in the first case but not the second.

The National Competition Council would be charged with assisting governments develop and refine principles in this area.

III. Implementation

The implementation of a national competition policy raises questions of the most appropriate institutional arrangements, the relevant legal and transitional issues, and the resource implications of the Committee's recommendations.

Institutional Arrangements

The Committee's views on the appropriate institutional structure for implementing a national competition policy were shaped by the detail of its policy proposals, and by its judgments on two key issues.

The first is the role of industry-specific versus more general regulators in the competition policy area. The Committee began its task with a sceptical bias against the need to establish separate regulators for individual industries. Apart from the risk of "capture" by the regulated industry, approaches of this kind fragment the application of competition policy and raise issues of consistency as between industries. There are also forgone opportunities to develop and apply the insights gained in one industry to analogous issues in other industries, a fragmentation of regulatory and analytical skills, and typically greater administrative costs. Overall, the Committee is satisfied that all aspects of its proposed policy framework can be fully and effectively performed by an economy-wide body with access to appropriate expertise through use of consultants or through development of internal expertise.

The second and more difficult issue concerns the respective roles of the Commonwealth, State and Territory Governments. While the Committee supports the adoption of cooperative models, this view is

tempered by the need to provide streamlined decision-making processes where important national interests were at stake and the importance of ensuring competition regulators could operate independently. The Committee was also influenced by the extent to which particular elements of its proposed policies impinged upon the prerogatives of individual governments. The Committee was mindful that it seems likely that the Commonwealth could implement substantially all of the Committee's recommendations unilaterally.

Based on these considerations, the Committee distinguished between administrative and policy roles, and between the general conduct rules — which already apply to most of the the economy and will have negligible impact on the prerogatives of States and Territory Governments — and the additional policy elements, where the impact is potentially more significant.

As indicated above, the Committee recommends that a **National Competition Council** be established jointly by the Commonwealth, State and Territory Governments to play a key role in policy decisions relating to the additional policy elements. While the composition of the body would be settled by all governments, the objective is to provide a high level and independent analytical and advisory body in which all governments would have confidence. As well as participating in its formation and agreeing on its composition, all Governments could give references to the body — either individually or collectively — on regulation review, structural reform of public monopolies, access regimes, monopoly pricing, and competitive neutrality.

Where it is proposed that a Commonwealth Minister could act unilaterally in certain circumstances — such as in relation to access regimes and, in even more limited cases, the application of the national prices oversight mechanism — a recommendation of the Council would be a necessary pre-condition to that action. The Council would also have a specific mandate to report on transitional issues associated with its recommendations.

The Council would comprise a full-time chairperson and perhaps up to four other members, some of whom might be part-time. While the Council would have its own Secretariat of perhaps 20 persons, in many cases it would be appropriate for it to contract out analytical work to other bodies, such as the Industry Commission, the Australian

Bureau of Agricultural and Resource Economics (ABARE) or State or private bodies. The Council could also draw on consultants or relevant experts from member governments on secondment. For example, the Industry Commission may be an appropriate source of analysis on structural reform issues, while a body such as ABARE may have a comparative advantage in analysing the impact of regulatory restrictions in the agricultural marketing area. Accordingly, while the body would be economy-wide in focus, there would be ample opportunity for it to draw on industry-specific expertise without duplicating the resources of other specialist bodies.

An **Australian Competition Commission** should be established to administer relevant aspects of the proposed competition policy. These include enforcement of the general conduct rules; administration of the authorisation process under those rules; oversight of declarations under the access regime and administration of any associated pro-competitive safeguards; and administration of the prices oversight mechanism. The body could also play a complementary role with respect to regulation review, with its work program in this area settled in consultation with the National Competition Council. There are also support roles in reporting to governments on alleged instances of non-compliance with agreed competitive neutrality principles; reporting on legislated exemptions from the Act; and promoting public education on competition matters, as well as any other functions specified under the Act.

The body would be formed from the existing Trade Practices Commission and Prices Surveillance Authority.

The Trade Practices Tribunal, which might be re-named the **Australian Competition Tribunal**, would continue to provide an appellate jurisdiction for authorisations under the competitive conduct rules.

Legal Issues

Although the Committee understands that the Commonwealth could implement most of its recommendations through greater use of its existing heads of constitutional power, it favours a cooperative approach to extending the coverage of the general conduct rules in the interests of comity, simplicity of legal drafting and certainty. A referral of powers from the States is the preferred implementation

model, although an application model is not ruled out. The Committee considers that unilateral Commonwealth legislation would be preferable to mirror legislation and any unreasonable delay in progressing cooperative reform.

Timetable for Implementation & Transitional Arrangements

Immediate implementation is recommended with respect to:

- Establishment of new institutional arrangements;

- Agreement on principles governing regulatory restrictions, structural reform of public monopolies and competitive neutrality;

- Enactment of amendments to Commonwealth legislation relating to:
  - content of conduct rules, other than price fixing;
  - modification of provision for regulatory exemptions under the Act;
  - imposition of more rigorous requirements for any new matters to be specifically authorised or approved under other Commonwealth laws; and
  - a prices oversight mechanism.

Application of the new arrangements should be delayed for specified periods with respect to:

- Extension of general conduct rules to areas excluded through constitutional limitations or the shield of the crown doctrine : 2 years;

- Extension of general conduct rules to areas specifically authorised or approved by Commonwealth regulations or State and Territory laws and regulations : 3 years; and

- Removal of administrative authorisation for price-fixing : within 4 years.

Implementation should be determined on a case-by-case basis with respect to:

- Reviews of particular regulatory restrictions on competition;
- Examination of particular structural reform proposals;
- Application of access regime to particular facilities; and
- Application of national prices oversight mechanism to newly declared firms.

Resource Issues

The resource requirements arising from the Committee's proposals would appear to be modest, and relate mainly to the creation and maintenance of the National Competition Council.

The Australian Competition Commission would progressively assume a slightly larger jurisdiction, as well as some new functions. However, the resource implications will depend on a variety of factors and will be expected to evolve over time.

C. CONCLUSION

The Committee has been impressed with the level of support for a national competition policy from governments and the business and wider community. There is widespread recognition of the critical role effective competition can play in the transformation of the Australian economy necessary to meet our current and future challenges.

The Committee has observed frustration at the pace of reform and its uneven incidence, and considers that early implementation of the Committee's proposals would assist in addressing these concerns.

Finally, full implementation of this report will require a level of cooperation between the Commonwealth, States and Territories which has only rarely been achieved in the past. The Committee, and most of the groups with which it consulted during this Inquiry, would encourage governments to see these recommendations in a positive light and reach early agreement on their implementation. Failure to do so will forgo urgently needed benefits for the Australian economy and community.

1. Towards a National Competition Policy

If Australia is to prosper as a nation, and maintain and improve living standards and opportunities for its people, it has no choice but to improve the productivity and international competitiveness of its firms and institutions. Australian organisations, irrespective of their size, location or ownership, must become more efficient, more innovative and more flexible.

Over the last decade or so, there has been a growing recognition, not only in Australia but around the world, of the role that competition plays in meeting these challenges. Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole.

For much of this century, competition policy was seen as limited to laws dealing with the anti-competitive conduct of firms. Particularly over the last decade, however, competition policy has been understood in a wider sense, embracing a range of laws and policy actions that influence the role of competition in the economy. Recent examples of pro-competitive reforms of these kinds range from the the introduction of competition into telecommunications to the deregulation of egg marketing.

Competition policy has been increasingly recognised as a key element of national economic policy. The national significance of competition policy was recognised by the establishment of this Inquiry[1] in October 1992 by the Prime Minister in consultation with the Premiers and Chief Ministers of the States and Territories. Drawing upon written submissions from nearly 150 organisations and interests, and discussions with all Australian Governments and a broad range of individuals and representative groups, this report presents the Inquiry's proposals for a national competition policy for Australia.

1 The Inquiry's terms of reference are set out at Annex A.

This Chapter provides a general introduction to the Committee's report.

Section A reviews the concept of competition and its relationship to community welfare and considers the bounds of competition policy.

Section B provides an outline of the evolution of national competition policy in Australia, including the new pressures for developing a more comprehensive competition policy framework that is truly national in application.

Section C discusses the approach adopted by this Inquiry.

Section D provides an outline of the Committee's report.

A. COMPETITION & COMPETITION POLICY

As a basis for developing its views on competition policy, the Committee has considered the concept of competition and its relationship to community welfare, and examined the wide range of policies relevant to competition.

1. Competition & Community Welfare

Competition may be defined as the "striving or potential striving of two or more persons or organisations against one another for the same or related objects".[2] Some aspects of this definition have been found to be particularly important by recent economic research:

- **Striving or potential striving:** It was once thought that markets would be efficient only when a number of firms were actually competing. Recent work suggests that the real likelihood of competition occurring (potential striving) can have a similar effect on the performance of a firm as actual striving.[3] Thus, a market which is highly open to potential rivals — known as a

2 Dennis F G, *'Competition' in the History of Economic Thought* (1977).

3 See Baumol W, "Contestable Markets : An Uprising in the Theory of Industry Structure", *American Economic Review* (March 1982), 72, 1-15; and Gilbert R J, "The Role of Potential Competition in Industrial Organisation", *Journal of Economic Perspectives* (Summer 1989) 107-127.

highly "contestable" market — may be of similar efficiency as a market with actual head-to-head competition.

- **Two or more persons or entities:** Early economic work suggested that large numbers of competitors were important for the effective working of competitive forces. However, in some cases competition between a few large firms may provide more economic benefit than competition between a large number of small firms. This may occur due to economies of scale and scope, not only in production but also in marketing, technology and, increasingly, in management.

- **Against one another:** While the simplest notion of competition sees firms providing identical products or services and competing largely on price, work in business strategy suggests that this is the exception rather than the rule. In practice, competition occurs through firms seeking to provide different mixes of benefits to consumers, some of which are already reflected in price and others of which are reflected in other elements of value to the customer such as service, quality or timeliness of delivery.[4]

- **Related objects:** Competition need not be between identical products or services. Economics has long recognised competition between substitutes. It is the striving to meet the same consumer need that is the essence of competition and this is reflected in the ways in which this is met by different market participants.

The relationship between competition and community welfare can be considered in terms of the impact of competition on economic efficiency and on other social goals.

(a) Economic Efficiency

Efficiency is a fundamental objective of competition policy because of the role it plays in enhancing community welfare. There are three components of economic efficiency:[5]

4 Hilmer F G, *Coming to Grips with Competitiveness and Productivity* (1991).

5 See Treasury (Sub 76), published separately as: *Treasury Submission to the National Competition Policy Review* (1993) at 3-5.

- **Technical or productive efficiency**, which is achieved where individual firms produce the goods and services that they offer to consumers at *least cost*. Competition can enhance technical efficiency by, for example, stimulating improvements in managerial performance, work practices, and the use of material inputs.

- **Allocative efficiency** is achieved where resources used to produce a set of goods or services are allocated to their highest valued uses (ie, those that provide the greatest benefit relative to costs). Competition tends to increase allocative efficiency, because firms that can use particular resources more productively can afford to bid those resources away from firms that cannot achieve the same level of returns.

- **Dynamic efficiency** reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities. Competition in markets for goods and services provides incentives to undertake research and development, effect innovation in product design, reform management structures and strategies and create new products and production processes.

Economic efficiency plays a vital role in enhancing community welfare because it increases the productive base of the economy, providing higher returns to producers in aggregate, and higher real wages. Economic efficiency also helps ensure that consumers are offered, over time, new and better products and existing products at lower cost. Because it spurs innovation and invention, competition helps create new jobs and new industries. The impact of increased competition on efficiency is illustrated by the recent entry of Optus into the Australian telecommunications market, which has already resulted in consumers being provided with a wider choice of services at lower cost.

Increased economic efficiency also means that firms are better able to adjust to changes, including unforeseen changes. This makes the economy more resilient and robust, and better able to adjust to changes in global economic conditions.

The promotion of effective competition and the protection of the competitive process are generally consistent with maximising

economic efficiency. However, there are some situations where unfettered competition is not consistent with economic efficiency. Examples of such "market failure" include situations where participants in a market have imperfect information about products, producers or suppliers, and the existence of so-called "natural monopolies" where a single firm can supply an entire market significantly more efficiently than two or more firms.

(b) Other Social Goals

The promotion of competition will often be consistent with a range of other social goals, including the empowerment of consumers.[6] However, there may be situations where competition, although consistent with efficiency objectives and in the interests of the community as a whole, is regarded as inconsistent with some other social objective. For example, governments may wish to confer special benefits on a particular group for equity or other reasons.

In some cases competition in a particular activity may be restricted to allow a public monopoly to pursue these wider objectives. Thus, for example, public monopolies in areas such as electricity, water and ports have often been directed to provide goods or services to particular groups at prices below the full costs of production, with the resulting deficits often funded through higher charges applied to other users. Arrangements of this kind would be difficult to sustain in a more competitive market.

Similarly, particular firms may seek exemption from rules governing competitive conduct to allow them to increase their returns relative to those that would be available in a more competitive market. Thus, for example, some agricultural producers have been permitted to collude to restrict output or fix prices at least in part to raise farm incomes or regional employment at the expense of consumers or other producers.

In a third situation, some suggest that rules governing competitive conduct should aim to protect competitors, rather than the competitive process, and should prevent larger firms from engaging in efficient competitive conduct where that would cause less efficient firms to become non-viable.

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6 Federal Bureau of Consumer Affairs (Sub 136). There is some evidence that competition tends to promote equal treatment of workers according to race and sex, as competitive firms cannot "afford" to discriminate: see TPC (Sub 69).

In each of these cases, however, it is possible for governments to achieve objectives of these kinds in ways that are less injurious to competition and the welfare of the community as a whole.

2. Competition Policy

In its broadest sense, competition policy encompasses all policy dealing with the extent and nature of competition in the economy.[7] It permeates a large body of legislation and government actions that influence permissible competitive behaviour by firms, the capacity of firms to contest particular economic activities and differences in the regulatory regimes faced by firms competing in the one market.

Traditionally, rules prohibiting the anti-competitive behaviour of firms have been seen as the cornerstone of competition policy. In Australia, rules of this kind are contained in Part IV of the Commonwealth *Trade Practices Act 1974* (TPA), which prohibits certain anti-competitive agreements; misuse of market power; exclusive dealing; resale price maintenance; anti-competitive price discrimination; and certain mergers.[8]

But competition policy is much wider than these provisions of the TPA. Based on the submissions received by this Inquiry, the Committee has concluded that an effective competition policy for Australia should address all six of the concerns outlined in Box 1.1.

Competition policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as in the sanctioning of anti-competitive arrangements on public benefit grounds.

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7 Policy governing the the extent of competition from international sources — an important part of trade policy — is treated as distinct from competition policy, notwithstanding its similar effects in terms of competition in the domestic market. Policy governing the protection of consumers as a group (such as provisions like Part V of the *Trade Practices Act 1974*) is also treated as distinct from competition policy, notwithstanding that both policies benefit consumers and some consumer protection provisions improve the efficiency of markets. The Committee's understanding of competition policy is consistent with the emphasis of its terms of reference and the overwhelming majority of submissions received by the Inquiry.

8 The content of Part IV of the Act is reviewed in detail in Chapters Three and Four.

Box 1.1 : Six Elements of a National Competition Policy

Concern	Current Approaches
1. **Anti-Competitive Conduct of Firms**	• Competitive conduct rules in Part IV of the Trade Practices Act (Cth), but with numerous exemptions.
2. **Unjustified Regulatory Restrictions on Competition**	• Reviews by individual governments without a systematic, national focus.
3. **Inappropriate Structure of Public Monopolies.**	• Mostly examined on a case-by-case basis by individual governments; recent inter-governmental work on electricity and rail.
4. **Denial of Access To Certain Facilities That Are Essential For Effective Competition**	• Some arrangements in place or being developed on an industry-specific basis (eg telecommunications); no general mechanism capable of effectively dealing with these issues across the economy.
5. **Monopoly Pricing**	• Surveillance of declared firms' prices under Commonwealth Prices Surveillance Act with important exemptions; various mechanisms in the States and Territories.
6. **Competitive Neutrality When Government Businesses Compete With Private Firms**	• Largely addressed on an ad hoc basis by individual governments; increasing moves towards corporatisation but on disparate models.

A key policy tool in this regard is the notion that the costs and benefits of alternative policy options should be evaluated in an open and rigorous way. Transparency has been recognised as a key feature for permitting exemptions from the TPA, and is specifically endorsed in the principles forming part of this Inquiry's terms of reference.[9] The Committee has sought to extend this principle to its policy proposals wherever practical and relevant.

9 See principle (c) of the agreed principles forming part of the Inquiry's terms of reference, which are set out in full at Annex A.

B. THE EVOLUTION OF NATIONAL COMPETITION POLICY

The evolution of national competition policy in Australia can be traced back at least as far as 1906, when the first national law dealing with restrictive business practices was enacted. During much of this century competition policy was regarded as synonymous with such laws, and a recurring theme has been the difficulty of achieving uniform coverage of competition laws due to constitutional constraints on the Federal Parliament.

The notion of competition policy has expanded in more recent times, giving rise to the need for a more comprehensive and durable competition policy framework to meet the needs of an integrated national market.

1. The Development of Australian Competition Law

The first national law dealing with restrictive business practices was the Commonwealth *Australian Industries Preservation Act 1906*.[10] It was inspired by the United States' Sherman Antitrust Act of 1890, and prohibited "monopolization" and "combinations" which restrained trade or commerce, or destroyed or injured Australian industries by unfair competition. The effect of the Act was substantially limited by a restrictive interpretation of the Commonwealth's constitutional powers in 1910,[11] however, and it thereafter fell into general disuse.[12] The Commonwealth made unsuccessful attempts to overcome the limitations of constitutional interpretation through a series of referenda in the first half of the century.[13]

During the 1950s and 1960s, there was growing disquiet with the cartelisation and concentration of Australian industry. Royal Commissions appointed to enquire into restrictive business practices

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10 Early State laws dealing with competition issues include the NSW *Monopolies Act 1923*; the Queensland *Profiteering Prevention Act 1948*; the Western Australian *Unfair Trading & Profit Control Act 1956*, which was replaced by the *Trade Associations Registration Act 1959*; and the Victorian *Collusive Practices Act 1965*.

11 See *Huddart, Parker & Co Pty Ltd* v *Moorehead* (1910) 8 CLR 330.

12 The Act was briefly revived with its first successful invocation in *Redfern* v *Dunlop Rubber Aust Ltd* (1964) 110 CLR 694, but by the time that decision was made the Commonwealth had announced its intention to enact new trade practices legislation.

13 Referenda were held in 1913, 1919, 1929 and 1944. See Nieuwenhuysen J P, *Australian Trade Practices* (2 ed, 1976) at 300.

highlighted the extent of restrictive business practices.[14] In 1961, there were over 600 trade associations in Australia, of which an estimated 58-66% operated restrictive trade practices.[15]

In 1962, the Commonwealth Attorney-General proposed a Restrictive Trade Practices Act. In the ensuing debate the proposed legislation was emasculated at the behest of various business lobby groups,[16] but ultimately the first TPA was enacted in 1965. The Act was relatively weak, requiring registration of certain agreements, with the possibility of eventual disallowance of those agreements if contrary to the public interest.[17] There was no provision dealing with resale price maintenance until 1971.

In 1971, the High Court held the 1965 Act invalid on constitutional grounds but, significantly, the Court provided a new interpretation of the Commonwealth's constitutional powers which permitted a greater involvement by the Commonwealth in the regulation of business conduct.[18]

The Parliament enacted replacement legislation,[19] but the election of a new Government in 1972 saw a new approach to competition law, based on prohibition rather than administrative investigation of conduct and permitting authorisation of conduct in the public interest. The current TPA became law in 1974 and was amended in 1977 following the report of the Swanson Committee.[20]

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14 Royal Commissions on Restrictive Trade Practices were conducted in Western Australia and Tasmania. See Walker G de Q, *Australian Monopoly Law* (1967) at 15.

15 Hunter A, "Restrictive Practices & Monopolies in Australia" (1961) 37 *Economic Record* 25.

16 See Pengilley W, "The Politics of Anti Trust and Big Business in Australia" (1973) 45 *Australian Quarterly* 53.

17 Collusive tendering and bidding were prohibited, but a defence was available if the agreement was registered and not made for the purposes of a particular auction or tender — a general practice of collusive tendering was permissible.

18 See *Strickland* v *Rocla Concrete Pipes & Ors* (1971) 124 CLR 468.

19 The Restrictive Practices Act was enacted in 1971. A Restrictive Trade Practices Bill and a Monopolies Commission Bill were introduced into Parliament in 1972, but these Bills lapsed with the 1972 election.

20 See Trade Practices Act Review Committee (Swanson Committee), *Report to the Minister for Business and Consumer Affairs* (1976). The principal amendments made in response to the Swanson recommendations were: replacement of provisions dealing with "restraint of trade" by a new test of "substantially lessening competition"; introduction of tougher provisions dealing with price fixing agreements; introduction of special provisions dealing with collective boycotts; the purposive element of s.46 (monopolisation – as it was then known) was made explicit; the exclusive dealing provisions were extended to cover restrictions imposed by buyers on sellers; the merger provision was amended to prohibit mergers which achieve or strengthen a position of

Prohibition of anti-competitive arrangements and judicial enforcement have remained the basic approach of competition law in Australia. Although there has been some ongoing re-examination and fine-tuning of the Act since, the basic form of the prohibitions has remained.

In 1986, the prohibition on misuse of market power was amended and the merger provisions were extended to certain overseas mergers.[21]

In 1992; following the reports of the Griffiths Committee[22] and the Cooney Committee,[23] the merger test was amended to prohibit mergers which substantially lessen competition and penalties for contraventions of the competition provisions were increased substantially.

Ongoing fine-tuning of the Act continues. In addition to this Inquiry, three other reviews are currently being conducted into various aspects of the Act:

- The Senate Standing Committee on Education, Employment and Training is enquiring into the operation of the secondary boycott provisions of the Act, and is to report in September 1993.

- An independent committee chaired by Mr Patrick Brazil, AO, is reviewing Part X of the Act, which governs international liner cargo shipping, and is to report by 31 October 1993.

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market control or dominance; the authorisation tests were simplified so that authorisation would be granted if, in all the circumstances, public benefits outweighed anti-competitive detriments.

21 *Trade Practices Revision Act 1986.*

22 See House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee), *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989). The Committee's main recommendations were that the misuse of market power provision be maintained in its existing form; that the penalties be substantially increased; and that mergers be prohibited if they create or enhance market dominance.

23 See Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee), *Mergers, Monopolies & Acquisitions Adequacy of Existing Legislative Controls* (1991). The Committee agreed that the misuse of market power provision be maintained in its existing form and that penalties be substantially increased. In contrast to the Griffiths Committee, it considered that mergers should be prohibited if they substantially lessen competition.

- The Australian Law Reform Commission is enquiring into the remedies available under the Act, with particular emphasis on remedies available under the consumer protection provisions of Part V of the Act, and is to report by 30 June 1994.

2. Developments in Wider Competition Policy

Over the last decade, Australians have come to appreciate the necessity of building a flexible, dynamic and efficient economy, and of the important role competition can play in meeting these goals.

Trade policy reform since the early 1980s has substantially improved competition in the domestic economy. The average level of effective assistance to manufacturing was reduced from 25% to 15% of the value of manufacturing output between 1981-82 and 1991-92.[24] Reductions in import barriers exposed many industries to the rigours of international competition, providing increased incentives to improve product quality, costs and innovation. For example, abolition of import quotas and phased tariff reductions in the motor vehicle industry has seen the average level of faults per vehicle fall by 39% since 1988.[25]

While trade policy reforms have increased the exposure of the internationally traded goods sector to competition, many goods and services provided by government businesses, some areas of agriculture, the professions and other important sectors are sheltered from international competition. Increasing competition and efficiency in these sectors requires more sustained attention to domestic constraints on competition. Application of the TPA is not of itself sufficient to enhance competition when the restrictions flow from government regulations or public ownership.

Government businesses account for 10% of Australia's GDP,[26] with rail, electricity, gas and water utilities alone accounting for nearly 5% of GDP.[27] Improving the efficiency of these sectors remains a national priority.

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24 INDECS, *State of Play 7, The Australian Economic Policy Debate* (1992).

25 EPAC (Sub 126) at 15.

26 EPAC, *Productivity Growth for Government Business Enterprises and the Private Sector*, 21 July 1993 (Media Release 8/93).

27 See Industry Commission, *Rail Transport* (1991); *Energy Generation & Distribution* (1991); *Water Resources & Waste Water Disposal* (1992).

Reforms in these sectors have ranged from commercialisation and corporatisation[28] to privatisation. While there have been some encouraging improvements — with productivity growth of government businesses now outstripping that in the private sector[29] — progress is being made from a low base, and Australian public enterprise productivity levels remain well below international best practice. For important industries such as rail, electricity and telecommunications, most Australian enterprises are achieving only 75% or less of the productivity levels achieved elsewhere.[30]

There is growing acceptance that introducing or enhancing competition will provide a substantial spur to improved performance in many of these sectors. While many public utilities were traditionally considered to be "natural" monopolies, so that a single producer could supply the entire market at least cost, technological changes and other developments have shown that the area of genuine natural monopoly is relatively small and diminishing. For example, it is now clear that long-distance telecommunication services are not a natural monopoly, and the introduction of competition into this area has already seen prices fall sharply.[31] Efforts to facilitate competition in electricity generation are also being progressed.[32]

The **agricultural sector** accounts for some 4% of Australia's GDP. While the export-oriented part of the sector is efficient, more domestically-focussed industries often rely on a range of anti-competitive arrangements to restrict competition and raise prices to

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28 "Commercialisation" usually refers to efforts to introduce commercial arrangements, including the application of user fees; it does not necessarily involve a change in the formal structure of the organisation (such as corporatisation). "Corporatisation" usually refers to the process of establishing a government business as a separate legal entity with more clearly specified objectives and usually a requirement to operate along private sector lines, including the payment of tax or tax-equivalent payments. The introduction of competition is not a necessary element of either reform, although the concepts can be subject to different interpretations in different jurisdictions.

29 EPAC, *Productivity Growth for Government Business Enterprises and the Private Sector*, 21 July 1993 (Media Release 8/93).

30 Forsyth P, *Public Enterprises: A Success Story of Microeconomic Reform?* (1993) at 32.

31 For example, STD peak rates on the Melbourne-Sydney route fell by over 20% between June 1992 (when Optus entered the market) and May 1993: AUSTEL advice based on published Telecom and Optus rates.

32 See NGMC, *National Grid Protocol* (First Issue - 1992).

consumers.[33] There have already been some significant reforms of statutory marketing arrangements at the Commonwealth and State levels.[34] For example, deregulation of egg production and marketing in NSW led average retail prices to fall by 38 cents per dozen, with savings to consumers of $21 million in a full year.[35] Nevertheless, many rural products remain subject to restrictive production or marketing arrangements.

Competition in many **professional services and occupations** has also been enhanced by recent reforms. In the case of the legal profession, for example, restrictions on advertising have been relaxed and several jurisdictions have removed the monopoly over conveyancing services,[36] and remaining restrictions face increasing public scrutiny.[37]

The benefits of enhancing competition in the economy are by no means limited to these three sectors. However, recent and ongoing reforms in these sectors highlight the opportunities that may be realised by a careful scrutiny of anti-competitive arrangements and regulations across the economy.

3. The Need for a National Competition Policy

The case for developing a national competition policy rests on a number of related considerations.

First, the pro-competitive reforms advanced to date have largely been progressed on a sector-by-sector basis, without the benefit of a broader policy framework or process. Reforms undertaken in this way are typically more difficult to achieve, with the ground rules — including the respective roles of Commonwealth, State and Territory Governments — having to be negotiated on a case-by-case basis. A national policy presents opportunities to progress reforms across a

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33 The IC estimated that in 1988-89 statutory marketing schemes effectively taxed users and consumers by some $550 million: See Industry Commission, *Statutory Marketing Arrangements for Primary Products*, (1991).

34 For an outline of recent Commonwealth and State reforms see submissions from the Queensland Govt (Sub 104), NSW Govt (Sub 117) and the DPIE (Sub 50).

35 NSW Egg Corporation, *Annual Report, 1990-91*.

36 See TPC, *The Legal Profession, Conveyancing & the Trade Practices Act* (1992) at Attachment B.

37 See, for example, Law Reform Commission of Victoria, *Restrictions on Legal Practice*, (1992); NSW Attorney-General's Department, *The Structure & Regulation of the Legal Profession: Issues Paper* (1992); TPC, *Study of the Professions: Legal Profession* (1992).

broader front, promote nationally consistent approaches and reduce the costs of developing a plethora of industry-specific or sub-national regulatory arrangements. It also presents important opportunities to increase the pace of reform, which is a question of considerable interest to businesses and consumers.

There is also increasing acknowledgment of the reality that Australia is for most significant purposes a single national market. The economic significance of State and Territory boundaries are diminishing rapidly as advances in transport and communications permit even the smallest firms to trade around the nation. Goods increasingly flow across State borders; the volume of interstate road freight has more than doubled in the last decade.[38] The number of passengers travelling on domestic airlines — typically interstate — trebled between 1971 and 1992.[39] And advances in communications have also reduced the significance of distance considerably.

The increasing national orientation of commercial life has been recognised by a series of significant cooperative ventures by Australian Governments. The 1990s have already seen national progress on a range of matters including the National Rail Corporation, road transport regulation, non-bank financial institutions, the Corporations Law and the mutual recognition of product standards and occupational licensing. Developing a nationally consistent approach to competition policy issues presents opportunities to further integrate the national market, reduce complexity and possibly achieve savings through reduced duplication.

At present the nearest Australia comes to nationally consistent competition policy principles are the competitive conduct rules contained in Part IV of the TPA. In this regard, the progress that has been made is readily illustrated by a comparison of the manner in which business was conducted in the early 1960s with the manner in which most business is conducted today. As one commentator recently observed of the Act, "this one piece of legislation has wrought a revolution in the way commerce is carried out in Australia".[40]

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38 ABS Interstate Freight Movements (various) Cat.No.9212.0.

39 ABS Yearbook 1992 & Dept of Transport & Communications AVSTATS.

40 Butler A, "The Quiet Revolution - Assessing the Impact of the Trade Practices Act" (1993) 7 *Commercial Law Quarterly* at 4.

But the most pressing deficiency in the Act is that it remains limited in its application, with coverage often depending on questions of ownership or corporate form rather than considerations of community welfare. While the Act applies to Commonwealth businesses, the exemption of some State- and Territory-owned businesses appears increasingly anomalous in light of commercialisation and similar reforms.[41] The continuing exemption of some agricultural marketing arrangements also affects efficiency, and runs counter to efforts to increase our export income through further processing of primary products in Australia. Similarly, the costs to consumers and the community generally of anti-competitive practices engaged in by professions such as lawyers has been receiving increasing attention.[42]

Inconsistent application of competitive conduct rules can allow exempted firms to engage in anti-competitive behaviour with effects reaching across State borders to the economy generally. For example, immunity in one State from, say, a merger rule could allow a business to acquire sufficient market power to deter competitive entry from firms located in neighbouring States. Similarly, allowing rural producers in one jurisdiction to engage in anti-competitive agreements can distort the operation of markets to the detriment of consumers and other producers wherever they may reside. Exemptions arising through constitutional limitations also harm consumers and firms within the same State; for example, intrastate unincorporated businesses can engage in price-fixing or other anti-competitive behaviour with impunity, to the detriment of consumers and other firms.

The absence of a consistent national approach to the other main areas of competition policy noted in Box 1.1 can also act as a source of inefficiency.

Regulatory restrictions on competition imposed by State and Territory law can have important inter-state and national implications. Firms enjoying statutory protection from competition in

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41 This assessment is reflected in the findings of the NSW Regulation Review Unit, *Application of the Commonwealth Trade Practices Act to NSW State Government Instrumentalities* (1988); Law Reform Commission of Victoria, *Competition Law : The Introduction of Restrictive Trade Practices Legislation in Victoria* (1992); and an overwhelming number of submissions to this Inquiry.

42 See *supra*, n.37.

one State can impose extra costs on consumers and businesses, including businesses that must contend with international competition, thus ultimately influencing the trading success of the nation as a whole.

The **structural reform of public monopolies** is also becoming a matter of inter-state and national interest, with the work of the National Grid Management Council on an inter-state electricity grid providing a recent example. Inter-governmental cooperation is required to allow open competition into the grid system. However, structural reform issues may remain important even once the market has been opened up to competition. For example, failure of an electricity utility in one State to undergo appropriate structural reform may allow that utility to cross-subsidise competition against utilities from other States, with consequent distortions in the emerging inter-state market.

Questions of **third-party access to facilities** which cannot economically be duplicated — such as major pipelines, electricity grids or rail tracks — are also increasingly raising issues at the inter-state and national level. Regulation of access arrangements to inter-state facilities at the State level would create administrative duplication and raise concerns over regulatory overlap.

Responses to **monopoly pricing issues** can also involve inter-State or national implications in some circumstances. Even where the pricing issues are predominantly within a single State, there may be advantage in developing nationally-consistent approaches to many issues, as well as in progressing pricing reforms in particular sectors in a coordinated way.

Government businesses sometimes enjoy special advantages when competing with private firms, giving rise to concerns over **competitive neutrality**. Inconsistent approaches to this issue between jurisdictions may distort inter-state markets, and may raise particular difficulties if government businesses from different jurisdictions engage in direct competition. This may be a feature of inter-state competition in electricity generation, for example.

Taken together, these considerations suggest significant benefits from developing nationally-consistent approaches to competition policy issues.

C. THE COMMITTEE'S APPROACH

The need for a national competition policy has been agreed by all Australian Governments.[43] The Governments have further agreed that a national competition policy should give effect to the principles set out in Box 1.2.

Box 1.2 : Agreed Principles for a National Competition Policy

(a) No participant in the market should be able to engage in anti-competitive conduct against the public interest;

(b) As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;

(c) Conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;

(d) Any changes in the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:

(i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition; and

(ii) in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.

These principles comprise an important part of the terms of reference for this Inquiry.

The Committee approached its task at a broad policy level, looking for common themes and issues rather than seeking to develop detailed proposals for each sector of the economy. At the same time, the proposals are designed to have the flexibility to apply sensibly to all the main issues presented to the Committee.

The Committee sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity, rail and gas. But the Committee is taking a bolder stance because of the

43 See Communique of Premiers & Chief Ministers' Meeting, Adelaide, 21-22 November 1991.

urgency of the reform task and a belief that precedents should be considered as steps towards more effective national reform rather than as desirable models in and of themselves.

The Committee's task raised three main challenges.

- *How should a national policy address cases where the benefits of competition are seen to be out-weighed by other factors?*

The Committee has not taken a blinkered or dogmatic view over the role of competition in society; in some cases competitive market outcomes will not meet the national interest, because they fail to deliver either efficiency or some other valued social objective. However, the Committee is satisfied that the general desirability of permitting competition was so well established that those who wish to restrict or inhibit competition should bear the burden of demonstrating why that is justified in the public interest. This principle is already reflected in the agreed principles dealing with anti-competitive market conduct, and the Committee proposes that it should apply equally to the actions of governments.

- *How should a national policy address the challenges of implementing micro-economic reform, recognising possible equity issues and that smaller and more concentrated groups often have powerful incentives to resist reforms that deliver substantial but sometimes more dispersed benefits to the wider community?*

The Committee responded to this issue by recommending processes that would increase the transparency of the costs of restricting competition; more closely aligning policy with the reality of the national market, giving more explicit priority to national interests; and placing particular emphasis on transitional measures where appropriate. In the case of extending the application of market conduct rules, where transitional impacts will be modest, currently exempt businesses will have time to adjust to new regulatory requirements. In the case of other reforms that may have more significant implications, the Committee's proposals include the establishment of an independent and expert body able to guide the transitional process.

- *How should the interests of nine governments be accommodated in a single national policy?*

The Committee approached this issue by supporting cooperative approaches between governments wherever these were considered capable of achieving the important national interests at stake. In some cases, principles are proposed that would be implemented by individual governments. In other cases, a single legal and administrative regime is seen as required, but cooperative processes for applying these regimes are given high priority. Importantly, the Committee also proposes participation of all Australian governments in the key policy-making institutional arrangements.

The Inquiry Process

The Committee took account of a wide spectrum of community views, with written submissions received from nearly 150 organisations and interests.[44] In October 1992 the Committee invited written submissions from interested persons and organisations through advertisements in the national and major regional newspapers. In February 1993 the Committee published an issues paper to elicit further comments on the issues under consideration. Submissions were received from major business, industry, professional and consumer organisations, trade unions, small and large businesses and private individuals, as well as Australian Governments.

The Committee met with Premiers, Chief Ministers, Ministers and senior officials of each State and Territory and senior representatives of several Commonwealth Departments and agencies. The Committee also consulted with a number of business, industry, professional and consumer organisations.

In accordance with its terms of reference, the Committee took account of overseas approaches where they were thought to offer lessons for Australia. Particular attention was given to other countries with federal systems of government and to the European Community. New Zealand approaches were of particular interest, not only because of its similar competition laws and the desirability of harmonising business laws in accordance with the Australia/New Zealand Closer Economic Relations Trade Agreement, but also

44 A list of submissions is set out in Annex B.

because of New Zealand's recent experiences in pro-competitive reforms.

In its initial terms of reference the Inquiry was to have reported in May 1993. However, the Committee's reporting date was extended until August 1993 to permit further consultations, particularly with State and Territory governments.[45]

D. STRUCTURE OF THIS REPORT

This Report comprises 15 chapters organised into three parts.

Part I deals with the competitive conduct rules that should operate under a national competition policy. These rules are designed to prevent firms from undermining the competitive process through anti-competitive conduct. The current rules, contained in Part IV of the TPA, include prohibitions on anti-competitive conduct such as anti-competitive agreements; misuse of market power; resale price maintenance and mergers that substantially lessen competition. The Committee considers that, with some relatively minor amendments, these should form the basis of the competitive conduct rules of a national competition policy.

At present, there are numerous mechanisms for exemption from the Act, many of which cannot be justified on any public interest grounds. The Committee considers that the coverage of the conduct rules should be broadened significantly and that remaining exemptions should be based more clearly on public benefit grounds.

Part II covers the five additional policy elements the Committee recommends should form part of a national competition policy. The Committee has found that application of the general conduct rules will not address many important competition policy issues facing Australia, particularly where competition is impeded through government regulation or ownership. An effective national competition policy must:

- facilitate the modification of unjustified regulatory restrictions on competition;

45 The Hon P J Keating MP, Media Release, 24 May 1993 (62/93).

- facilitate the structural reform of public monopolies;

- enable firms to have assured access to certain "essential facilities" where such access is required to compete in markets;

- deal with "monopoly pricing" issues where measures to enhance competition are not practicable or sufficient; and

- address "competitive neutrality" issues arising where government businesses enjoy net advantages by virtue of being government-owned when competing with private firms.

These measures are vital to enhancing competition and efficiency in those sectors of the economy currently sheltered from competition.

Part III covers the implementation of the Committee's proposals. It deals with institutional, legal, transitional and resource issues. The Committee proposes that two key institutions would assist to implement the Committee's proposals. A National Competition Council would be created jointly by Commonwealth, State and Territory Governments to assist in coordinating reform and would provide independent and expert advice on the additional policy elements, including transitional issues. An Australian Competition Commission would be formed from the TPC and PSA to administer the general conduct rules and parts of the additional policy elements.