

2. Effects of Reform on Society and the Economy

2.1 Some broad perspectives

There has been much discussion of the effects of National Competition Policy over the last few months. Claims have been made that competition policy is contributing to a range of social and economic problems – including unemployment, environmental damage and cutbacks in government services.

The recent debate reflects both resistance by some groups to the removal of anti-competitive protections and privileges, as well as genuine concerns in the wider community. The changes that have taken place in the Australian economy over recent decades have caused much social dislocation. Much of this is due to things Australian governments have no control over – for example, technological change, falling world commodity prices, and the emergence of ‘globalization’. But government policies – such as the closure of rural rail lines – have also contributed to the changes, and governments have not always dealt adequately with the social effects of change.

That said, many concerns commonly ‘blamed’ on NCP – such as privatisation, compulsory competitive tendering and cuts in public services – are based on a serious misconception. In fact, the NCP agreements contain no requirement – or mention – of privatisation, competitive tendering or reducing the provision of community services.

Instead, the focus of NCP is to promote the best value for money in delivering goods and services which the community values. But NCP does not mandate which

products should be provided. Nor does it seek to judge whether particular products should be delivered by the private or public sector.

However NCP *will* affect many socio-economic issues such as employment, the environment and the provision of government services. While community perceptions appear to be that these effects are usually negative, the reality is more complex. As discussed in section 2.3, for example, while reform may reduce employment in previously sheltered areas of the economy, it can also play a significant role in generating new employment opportunities.

The Productivity Commission's current *Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia* is expected to provide important evidence of the socio-economic effects of reform.

So too will more specific research programs. For example, the NSW Government has established an Independent Advisory Committee to provide guidance on the assessment of socio-economic impacts of the water reforms, including enhanced monitoring of long-term impacts. The Advisory Committee has provided methodological advice on socio-economic assessment in the form of a discussion paper: *NSW Water Reforms – Guidelines for Socio-economic Assessment*. This paper also forms the basis for community consultation on reform.

In fact, the NCP framework was designed to ensure that, while there may be a mixture of costs and benefits, the overall social and economic effects of any particular reform will be positive. Under NCP, competition is not a 'holy grail' to be introduced for its own sake. Governments agreed to implement NCP with the express purpose of serving the public interest. As has been noted, a central contribution that NCP can offer is to help reduce costs to Australian households and businesses (see Box 7), fuelling rising living standards, and making our industries more competitive, creating scope for higher economic growth and sustainable job creation. These benefits also help provide growth in the revenue base of governments, providing funds for important programs such as community services, welfare and protection of the environment.

Box 7 Some early outcomes from competition reform⁴

- Following the introduction of competition, electricity bills fell by about 23 to 30 percent on average, for those NSW and Victorian businesses covered by the national competitive market; while wholesale prices in Queensland fell by around 23 percent after its internal competitive electricity market commenced.
- Gas prices for major industrial users fell 50 percent after deregulation of the Pilbara market in 1995, while gas distribution tariffs are set to fall 60 percent by the year 2000 in NSW.
- Rail freight rates in Western Australia have fallen by 42 percent in real terms since 1991-92, while rail freight rates for the Perth-Melbourne route fell 40 percent, and service quality and transit times improved, following the introduction of competition in 1995.
- Conveyancing fees in NSW fell 17 percent between 1994 and 1996, after the abolition of the legal profession's monopoly and the removal of price scheduling and advertising restrictions, leading to an annual saving to consumers of at least \$86 million.
- Prices for the outputs of government trading enterprises fell substantially between 1991-92 and 1995-96, and payments to governments doubled, due partly to competition reforms. More recent evidence shows that these trends are continuing. In the five years to 1996-97, the sharpest price reductions occurred in electricity (24 percent), port services (23 percent), telecommunications (23 percent) and air traffic services (40 percent).

⁴ Adapted from the Council's 1997-98 Annual Report. The source material for this information is provided in the Annual Report.

Box 7 ...cont

- In Queensland, ten of the seventeen largest local councils have implemented two part tariffs for water, resulting in an average saving in water usage of 20 percent in the first year.
- Following a review of business licensing in NSW that found significant duplication and overlap, some 72 licenses have been repealed and more are being scrutinised. Among other changes, 44 categories have been collapsed into just three.

For example, the water reforms – among the most far reaching in the NCP framework – embody a comprehensive package of measures aimed at reaping benefits from economic, social and environmental perspectives. The reforms aim to promote more efficient use of water through price reform and the introduction of tradeable allocations, allowing water to be used in ways that the community places highest value on. At the same time, reforms to pricing and investment guidelines will encourage better conservation and greater accountability in environmentally-sensitive matters such as dam construction. The environment is also being recognised as a legitimate user of water, with NSW, for example, reserving a 10% environmental flow for seven key rivers in 1998-99. Meanwhile, in several States, pensioners and other low income groups will receive government-funded rebates on water and sewerage bills as community service obligations.

The establishment of appropriate drinking water quality standards, water quality monitoring and catchment management policies are other important elements of the water package. Victoria, for example, will allocate \$1 billion to ensure that virtually all country towns have good clean water to international standards by 2001. Similarly, NSW is committing \$855 million to upgrade country town water supply and sewerage treatment works.

The recent crises over water quality in Sydney and Adelaide have highlighted the importance of these issues. In response to the Sydney crisis, the NSW Government has announced structural reform to Sydney Water, with control over treatment

plants, dams and water catchments being shifted to a new Sydney Catchment Authority. At the same time, water quality testing will be transferred to a new independent laboratory. These structural changes are consistent with the NCP water reform principles on institutional reform.

Similarly, the recent Victorian gas crisis illustrated some of the socio-economic benefits of the NCP gas reform program. The suspension of Victorian gas supplies following the Longford disaster in September 1998 would have left Victoria without gas for emergency services in the absence of NCP reform. But implementation of the National Gas Pipelines Access Code, a centrepiece of NCP gas reform, was a critical factor underpinning the construction of a \$50 million 'interlink' pipeline between New South Wales and Victoria, which allowed emergency supplies of gas to flow into Victoria from interstate throughout the crisis. This enabled hospitals to be supplied with gas, and also enabled pressure to be maintained in the Victorian gas network, averting a major collapse of the system which could have shut down gas supplies in the State for several months.

While all of the NCP reforms were designed to deliver social and economic benefits, many specific reforms are also subject to case-by-case public interest assessments to determine whether a net community benefit exists. These assessments take account of a wide range of social, environmental and economic perspectives (see Appendix 1). The Council believes that this framework enables governments to achieve policy outcomes that balance economic, social and environmental considerations.

But while the public interest test provides checks and balances from the viewpoint of the community as a whole, it cannot ensure that *every* person will be better off from NCP reform. This is because most barriers to competition benefit particular groups or individuals by sheltering them from the market place. What governments must assess in applying the public interest test is whether the benefits of anti-competitive restrictions to particular individuals or groups can justify imposing costs on the rest of the community – through, for example, higher prices or higher taxes necessary to fund inefficient service provision.

Given that reform can impose costs on some groups, it is important that the application of the NCP public interest test be rigorous, independent, and focus on

the interests of the community at large.

In some cases, a rigorous assessment will find that the costs imposed on the community are justified – for example, a barrier to competition may be judged as necessary to sustain regional economic development, employment and social cohesion in a remote community.

In other cases, the benefits conferred on a particular group may be outweighed by the costs imposed by barriers to competition on the community at large – pointing to reform as the best option to serve the public interest.

But sometimes when this occurs, the information disseminated in the community about reform may still focus on the costs, giving the impression that the community is worse off. There are two reasons for this.

Firstly, those groups who become exposed to competition after previously being sheltered are often very vocal about explaining – and in some cases exaggerating – the potential costs to them about the loss of privileges.

Second, the costs of competition reform often occur relatively quickly, and tend to be concentrated among particular groups, industries or geographical areas newly exposed to competition. These costs can involve hardship for the people affected, and often become the subject of media attention.

At the same time, the benefits of competition reform tend to flow more evenly across the economy – across the industrial, geographical and employment spectrum – through lower costs and prices and the expansion of industry arising from these changes. Sometimes these benefits take time to flow through, and the link to competition reforms introduced months or years earlier is not always easy to see.

It should also be borne in mind that failure to introduce reform can impose its own costs on the community. For example, prior to introducing national reforms in electricity, the industry was characterised by overcapitalisation in power stations, poor efficiency and high energy charges which damaged the international competitiveness of Australian industry. Similarly, uncompetitive structures in

the water industry have contributed to inefficient approaches to infrastructure, poor conservation and degradation of the nation's rivers. Finally, in gas, the potential risks of monopoly structures in the upstream gas sector were graphically illustrated by Victoria's Longford gas crisis in September 1998.

2.2 Adjustment assistance

As has been noted, a public interest assessment will sometimes find that a particular reform should proceed because it delivers important community benefits – even though it may impose costs on people in particular regions, industries or communities directly exposed to reform.

The Council emphasised in its 1996-97 and 1997-98 Annual Reports that adjustment assistance may be appropriate in some instances to facilitate desirable changes to the structure of the economy and to compensate people or communities adversely affected by specific reforms.

While various measures, such as social security payments and subsidised training schemes, already exist for people who lose their jobs as part of normal economic activity, governments may need to consider whether *additional* assistance should be offered to those directly affected by particular reforms such as NCP.

In the longer term, governments may need to give weight to these issues in their approach to policies such as social security, education and training and labour market programs. In the short to medium term, they may also need to consider targeted adjustment assistance.

One form of assistance adopted for most of the NCP reforms is to *phase* reform. This enables proper consultation between governments and communities about aspects of reform, and gives affected groups breathing space to adapt to changing conditions. For example, the electricity and gas reforms which commenced in the

mid-1990s (and earlier in some jurisdictions) are being phased in for completion by around 1999-2003 (reform is scheduled to be completed earlier in some jurisdictions than others). And the legislation review program, which commenced in 1995, is to be completed by all governments by the end of 2000.

It should be noted that phasing in reform can sometimes delay important benefits, without postponing the costs – creating the risk of skewed outcomes. For example, the electricity reforms have already resulted in significant restructuring of energy utilities, creating job losses in parts of the industry. But the phased reform timetable is delaying some of the benefits of cheaper electricity to small business and households, in turn holding up some of the important positive spin-offs to employment.

Alternatively, it may be appropriate to *directly compensate* people where reforms deprive them of pre-existing property rights and where rapid implementation is desirable. *Specific retraining assistance* programs may be appropriate where reforms are likely to involve lower employment in an industry where the people concerned have specific skills not readily transferable to other jobs.

As a variant on this, governments can provide *pro-active adjustment assistance*. This issue has been acknowledged in relation to a number of NCP reforms, including the legislation review program. For example, the Industry Commission's review of the *Customs Tariff Act 1995 – Textiles Clothing and Footwear Arrangements* devotes around 50 pages to adjustment issues, arguing that:

Adjustment assistance to TCF employees is an important issue because employment in TCF manufacturing can be expected to decline regardless of tariff cuts, pauses, or indeed, increases.... Government assistance for labour adjustment is justified, not only for efficiency reasons, but perhaps more importantly, on equity grounds.

The review made several recommendations on adjustment assistance, including changed eligibility criteria for employment assistance services and additional funding for these activities.

The water reforms are another area of the NCP package which specifically recognise structural adjustment issues. The COAG agreements underpinning water reform make specific reference to phasing reform over a five to seven year period, noting

that the effectiveness of reform will partly depend on the availability of financial resources to facilitate structural adjustment.

The NSW Government has developed a \$33 million structural adjustment package to assist irrigation farmers to adjust to the new water management arrangements. The package targets farm business planning, irrigation skills training, financial assistance for water-efficient techniques and technologies, and re-establishment assistance, where required. On a broader scale, NSW is committing \$200 million to support land and water management plans to provide a sustainable future for key agricultural areas. This adjustment package will be refined in conjunction with socio-economic analysis to be conducted as part of water reform implementation (NSW Government 1998).

Some States have also implemented pro-active adjustment assistance in conjunction with commercialisation reforms. For example, both Queensland and Victoria have made policy decisions to make wider use of competitive tendering in local government service provision. But prior to putting some of their functions to tender, some councils in Queensland and Victoria have offered training for their staff who previously undertook the relevant functions. This provided 'in house' staff with a better opportunity to compete successfully in the tendering process.

The design and funding of adjustment assistance programs is a matter for governments. The Council notes, however, that funds totaling \$16 billion are to be paid by the Commonwealth to those jurisdictions implementing NCP. The payments were linked to the NCP implementation package as a means of sharing the benefits of reform more equitably between levels of government. Taking this a step further, one option governments could consider is applying part of these funds to situations where adjustment assistance is judged necessary.

In considering whether specific adjustment assistance is warranted, governments need to take account of a range of equity matters. For example, issues may arise if assistance is given to people losing their jobs due to one form of change – such as government policy – while others who lose their jobs for reasons such as technological changes or overseas recessions, must make do with existing assistance programs. On the other hand, specifically targeted assistance may be

warranted if the people affected have few alternative choices available – for example, if reform causes significant unemployment in a remote area.

Secondly, in some cases, the ‘adverse effects’ some people incur from reform are, in effect, simply a removal of the privileges they have previously enjoyed at the expense of other members of the community. This reduces the strength of any equity arguments for providing special adjustment assistance in those cases.

Third, adjustment assistance is costly to other members of the community, and should be structured to benefit both those who receive it and the community as a whole. As a general principle, any special assistance should not cost more than the benefits of reform – indeed, reform is only warranted in the first place if the benefits outweigh adjustment costs. And where possible, assistance should focus on ways of equipping people with skills to *adjust* to change, with an eye to promoting their self-sufficiency in the future.

In summary, these considerations mean that any special adjustment assistance for people affected by particular reforms, over and above that available for people generally, needs to be rigorously justified, transitional in nature, and targeted at equipping people to adjust to change. For example, specific assistance may sometimes be warranted to address the costs of reform in regional areas where the benefits from reform are significant, the alternative employment and business opportunities in the region are limited and the skills of people or their investment in specific businesses means that the adjustment process is particularly difficult.

In these cases governments need to consider the best mix of phasing reform and providing programs that facilitate change and reduce the burden of change faced by individuals.

2.3 Effects on employment

Employment is an explicit consideration in the NCP public interest test and as such, is one of the matters to be weighed up when deciding whether to apply several of the NCP reforms – reforming anti-competitive legislation, applying structural reform to public monopolies and applying competitive neutrality to government businesses.

The NCP reforms will affect employment in several ways. The Council examined some of these effects in its 1996-97 Annual Report, noting that there will be a range of effects, both positive and negative, for employment.⁵

The Council pointed out that particularly in the short term, jobs will be lost in some of the industries directly exposed to reform, as existing businesses experience greater pressures to lift productivity and reduce costs in order to compete with new entrants in the market.

There is evidence that, in the longer term at least, those areas of the economy directly exposed to reform may also experience positive jobs growth. Indeed Professor Fred Hilmer, in a September 1997 speech, presented evidence from the early 1990s that the sectors undergoing greatest reform were also those experiencing the best growth in jobs, suggesting that some of the jobs shed by businesses newly exposed to reform may be offset to some extent by an increase in jobs provided by new businesses entering those markets – or related markets:

The sectors where reforms are proceeding have had the best job growth. For example, between 1991 and 1995 employment in these five sectors grew by about 60,000 jobs, reflecting an increase of 80,000 jobs in small and medium businesses offset by a 20,000 job decline in large businesses. Conversely, in the sectors where reforms are stalling, jobs are shrinking, with losses in small and medium businesses more than offsetting the gains in employment in large businesses (Hilmer 1997).⁶

⁵ Section A2.4 of the Annual Report.

⁶ The sectors identified by Hilmer as proceeding with reform in the 1991-95 period were property and business services, transport, construction, communications and finance. The industries where reform was said to be stalling were accommodation/restaurants, utilities, agriculture, retail and manufacturing.

That said, a number of businesses newly exposed to reform are likely to shed jobs in the short term at least. This has been observed, for example, in regard to some electricity and telecommunications businesses.

However, there are likely to be employment gains, particularly in other industries. Competition helps to lift productivity, bringing cheaper prices for the products of newly exposed industries. This boosts the real incomes of Australian households, stimulating higher levels of consumer spending, in turn encouraging firms to increase production and employ more workers.

NCP also improves the cost competitiveness of thousands of Australian businesses which rely on services like electricity and legal advice. These and many other services are becoming cheaper as a result of reform, helping Australian industry win new business. In particular, it makes our exporters more competitive on overseas markets, and helps local firms compete more aggressively with imports. Once again, these changes point to higher levels of domestic production, and scope for sustainable job opportunities for Australian workers.

To take an example, many State Governments now allow electricity businesses – including businesses from other States – to compete with one another. This has put pressure on producers to improve standards and cut unnecessary costs so they can offer the best value to customers. In some cases, cost-cutting has meant reducing the number of workers on the payroll.

But this process is also contributing to cheaper electricity bills. Competition has cut power bills for businesses able to choose their electricity supplier in NSW by around 30 percent, and in Victoria by around 23 percent (ACM 1998). Households will also benefit. Indeed, already in Victoria, the average household gained a 9.2 percent real reduction in electricity prices between 1992 and 1997 (Victorian Government, 1997). Lower power bills mean that families have more money to spend on other products. This, in turn, encourages a wide range of businesses throughout the economy to expand and employ more workers. So, while some jobs may be lost in industries newly exposed to competition, jobs in other industries – often important export industries – are being created.

Beyond the effects on employment discussed so far, NCP should improve the productivity and flexibility of our economy as a whole, and thereby reduce our vulnerability to adverse changes in the world trading environment, such as those currently being experienced in Asia. To the extent that NCP can help fire-proof us from external shocks, it can help to reduce the impact of overseas recessions on the domestic jobs market. While the full effects of the Asian crisis are yet to work through, Australia's relatively stable performance in the face of the crisis may be partly attributable to the increased flexibility in the economy resulting from reforms such as NCP.

While the employment effects of NCP are diverse, there are strong community perceptions that the effects are mainly negative. As is the case for reform more generally, this is partly because the negative employment effects of competition often occur relatively quickly, and tend to be concentrated among particular groups, industries or geographical areas directly exposed to competition.

At the same time, the employment benefits of competition reform tend to flow more evenly across the economy through cheaper costs and prices and the expansion of industry arising from these changes. It is not always easy for people to make the connection between competition reforms introduced several months ago in a particular industry and new jobs being created in unrelated industries, in some cases, thousands of kilometres away.

The diffuse and 'flow-on' nature of the effects of reform on employment makes reliable quantitative analysis a difficult task. In the longer term, however, the impacts of NCP on Australia's cost competitiveness, international trade and economic growth should provide scope for net gains in employment. Even so, the gains may flow unevenly, with expanded job opportunities in many sectors and regions occurring alongside contractions in some others.

In the process, some people in the community are likely to face hardship, especially those people with specific skills experiencing a fall in demand, or living in a geographical area facing a net decline in job opportunities.

Where an NCP reform has the potential to impose hardship of this kind, such costs should be taken full account of in the public interest test and weighed against the

costs of failing to introduce reform – for example, unnecessarily high prices and blocking new employment growth in other industries.

At the same time, the Council argued in its 1996-97 Annual Report that to get the maximum benefit in terms of jobs, NCP should be implemented in conjunction with policies specifically designed to manage the distributional effects on employment – for example, education and training programs to enhance the vocational skills base of unemployed workers and young people about to enter the labour force. The Council re-emphasises the point here.

2.4 Equity and social welfare

Improving equity is an important goal of Australian governments. This is recognised in the NCP framework. For example, the water reforms expressly allow for the continuation of targeted and justifiable community service obligations and subsidies – such as pensioner rebates – where the cost is made transparent and fully disclosed.

More generally equity and social welfare matters are explicit considerations in the NCP public interest test, and as such, are considered when deciding whether to apply several key reforms. Specifically, clause 1(3) of the Competition Principles Agreement requires that “social welfare and equity considerations, including community service obligations” be taken into account when assessing the merits of reforming anti-competitive legislation, applying structural reform to public monopolies and applying competitive neutrality to government businesses.

Importantly, under the NCP agreements, equity and social welfare considerations carry the same weight as financial considerations in the public interest test. For example, if a proposed reform impacts negatively on equity issues, this would count as a cost in the public interest test – and be a factor tilting the scales away from reform. But the reality is that a particular reform will usually entail a range of positive and negative effects on equity.

For example, NCP exposes previously sheltered areas of the economy to competition, creating the risk of lower incomes, business failure or unemployment for some of the people directly exposed to reform.

On the other hand, in the absence of reform, some groups are able to do business from behind anti-competitive arrangements, allowing them to maintain incomes, or work and lifestyle conditions at levels higher than they otherwise could. The legal profession's monopoly on conveyancing in Queensland may be an example of this (see Box 8), as may be the controls applying to certain medical specialists (see Box 9). Meanwhile, people in otherwise similar circumstances do not enjoy these privileges. For this reason, one principle of NCP is that restrictions on competition should be maintained only where they confer an *overall* community benefit, rather than simply providing privileges for the sheltered group at the expense of others.

In addition, many NCP measures will encourage cheaper prices of affected services, helping to reduce the gap between rich and poor households. For example, the energy reforms are bringing substantial reductions in electricity and gas prices. These price changes will cut consumers' power bills. As low-income households spend a larger proportion of their incomes on energy than households on high incomes, these reforms should improve equity.⁷

Overall, the effects of reform on equity are likely to be a mixture – some good, some bad, and these diverse effects should be given the same weight in public benefit assessments as efficiency considerations. Where a reform, while providing an overall community benefit, will adversely affect a particular group, industry or community, governments should consider the case for appropriate adjustment assistance to equip people to cope with change (see section 2.2).

The Council highlighted the importance of equity issues in its 1996-97 and 1997-98 Annual Reports, noting that a fair and just society should be a concomitant objective of governments to the implementation of competition policy and like reforms.

⁷ While household power bills are likely to fall as a result of the NCP energy reforms, it should be recognised that cross-subsidies are also being phased out, meaning that business customers will receive more direct benefits than households. Larger businesses are also likely to obtain greater cost reductions than smaller businesses. That said, lower prices for business inputs can be expected to lead to a reduction in their prices and/or an expansion in their sales, and thus in their demand for labour. This in turn will benefit households, particularly the less well-off.

Box 8 Anti-competitive regulation and equity: conveyancing

Under Queensland's *Legal Practitioners Act 1995*, conveyancing is restricted essentially to members of the legal profession.

Similar restrictions used to apply in most other States and Territories, but have been removed over recent years. In NSW in the early 1990s, the market was opened up to non-lawyers with appropriate qualifications, and fees scales and advertising restrictions were removed. Conveyancing fees subsequently fell by 17 percent resulting in a saving to NSW consumers of at least \$86 million (Baker 1996).⁸

In other words, these restrictions had effectively boosted the incomes of members of the legal profession, but at the expense of consumers and others wishing to compete for their custom.

The Queensland restrictions are to be reviewed under the NCP legislation review program. This review will need to determine, among other things, whether there is a public interest justification for government regulation of conveyancing services and, if there is, whether community objectives can be achieved in other ways, such as the approach taken in NSW.

⁸ This figure is based on the size of the NSW conveyancing market in 1992-93, converted to 1996 dollars. However, the study notes that the market has increased in both volume and size since then, suggesting that the savings estimate is conservative (Baker 1996, 37).

Box 9 Controls on entry into medical specialist professions

Medical ‘colleges’ typically set numerical restrictions on who can train to become a medical practitioner.

Patterson (1994) argued that supply restrictions have inflated incomes in several medical specialties. For example:

- the ratio of cardio-thoracic surgeons to the population size had been held well below the target set by governments. On average, cardio-thoracic surgeons earned almost \$400 000 per annum, with the top 25 percent of surgeons grossing almost \$700 000 per annum;
- the top quartile of orthopaedic surgeons earned approximately \$400 000 per annum, with high co-payments indicating market power; and
- shortages of ophthalmologists contributed to top quartile earnings of up to almost \$600 000 per annum⁹.

Patterson also found evidence suggesting that supply restrictions had caused an extension in treatment waiting lists.

Following Patterson’s report, the Australian Health Ministers established the Australian Medical Workforce Advisory Committee within the health portfolio, to address issues of appropriate supply on a case-by-case basis.

Under NCP, the ACCC is also examining entry restrictions for compliance with Part IV of the *Trade Practices Act 1974*, and State-based legislative restrictions on practice are also scheduled for review.

⁹ Patterson calculated earnings figures from data supplied by the Department of Health for 1991-92. The Australian Institute of Health and Welfare has indicated to the Council that current data is not publicly available.

The Council cited evidence of a greater dispersion of incomes and opportunities among people as we move to a so-called 'post-industrial' or 'information age' society. Work relying mainly on intellectual skills is generally attracting higher rewards compared with other forms of work. Meanwhile, people without an increasingly high base level of intellectual skills are losing ground (Reich 1993, Harding 1997). This greater dispersion arguably increases the case for greater efforts to redistribute from rich to poor, to promote social cohesion as well as for equity itself.

In addressing equity, it is important that the measures used achieve their objectives as efficiently as possible. Retaining barriers to competition is unlikely to be an efficient way of achieving equity objectives for several reasons. As noted earlier, reform can *improve* equity by reducing the prices of essential services such as energy, and by removing anti-competitive arrangements that confer unfair privileges on particular groups in society. There are also other reasons:

- competition reform can promote higher government revenue (by lifting the nation's competitiveness and economic growth, and hence taxation). At the same time, reforms such as competitive neutrality help to control government costs and encourage better value for money in community service provision. These effects can help governments finance important community services which may otherwise be threatened by budgetary constraints; and
- in many cases, protecting jobs through anti-competitive processes may not deliver the welfare benefits intended. For example, much of the assistance flows to employers, while some community welfare is lost altogether, as barriers to competition result in prices for goods and services being unnecessarily high – forcing households to reduce their levels of consumption compared to what they could afford in a competitive market.

Instead, there are more effective ways of addressing equity issues than to retreat from competition policy – for example, through reform to government policies that are relatively efficient means of delivering equity, such as tax, social security, community services and community service obligations (see below) and labour market programs.

2.5 Community service obligations (CSOs)

Governments often seek to address equity through community service obligations. CSOs are goods and services which businesses are required or expected to supply to certain sections of the community on a non-commercial basis. Traditionally, many government-owned businesses have been required to provide CSOs to meet government social objectives.

For example, the Commonwealth Government requires Australia Post to provide a letter delivery service throughout Australia at a uniform rate of postage. While the current rate of 45 cents is more than sufficient to cover the costs of many mail users, it is insufficient to cover the costs of some regional and remote users. Hence, this CSO involves a cross-subsidy from some users of the service to others.

CSOs can be provided in various ways. One is the way just described, where a government business is instructed to provide certain services and does so using cross-subsidies. To ensure it is able to do this, governments have often used anti-competitive legislation to give the business a monopoly, and thereby prevent competitors undercutting it in the commercially viable areas of the market. Another approach is to allow competition, but to provide subsidies for the government business to provide loss-making services, financed either from the budget or from a levy on other businesses competing in the market. This transfers the source of funding from other consumers to taxpayers generally. Finally, the government can allow full competition and put the loss-making service out to tender.

The House of Representatives Standing Committee on Financial Institutions and Public Administration (Hawker Committee) noted in its 1997 Report, *Cultivating Competition*, that all jurisdictions have revised their approach to CSOs in recent years, with greater emphasis on transparency, a shift away from the traditional funding method of cross-subsidisation towards direct funding, and in some cases, the contracting out of CSOs. The Hawker Committee endorsed reform aimed at improving the efficient and effective delivery of CSOs, including improved reporting and monitoring procedures.

These reforms were set in train prior to NCP. However, NCP reiterates the importance of effective CSO delivery. The Hawker Committee reported community concerns that NCP goes further than this and seeks to dismantle important CSOs. But this is *not* the case. Governments are free to transparently subsidise important community services for well-defined target groups – such as aged pensioners – under the NCP reforms. In fact, competition reform can help governments provide services more cost-effectively, leaving them with more money to subsidise important CSOs.

Further, improved transparency and better reporting enables the community to monitor whether governments are delivering CSOs effectively. Targeted funding through the government's budget also provides a framework to ensure the continued delivery and funding of important CSOs.

As the Hawker Committee notes:

Competition reforms are not about winding back CSOs, but are more concerned with the most cost effective means of delivery... NCP has reinforced and encouraged a greater awareness of what CSOs are, what they cost, how they are funded and how they are able to be delivered. (Hawker 1997, 4.60; 5.42).

In short, the NCP process recognises the importance placed by society on providing important community service obligations. This is explicitly acknowledged in the NCP public interest test, which requires that CSOs be taken into account in weighing up the costs and benefits of proceeding with particular reforms.

While NCP is fully consistent with providing important CSOs, the NCP program is also consistent with the established trend to review the way in which CSOs are defined, funded and delivered.

For example, the water reforms require pricing based on consumption, full cost recovery and desirably the removal of cross-subsidies. The water agreements specify that, where water delivery businesses are required to provide water services to a particular class of customers at less than full cost, this subsidy is to be fully disclosed and ideally paid to the service deliverer as a CSO.

Similarly, while the NCP energy reforms generally involve the phasing out of cross-subsidies, they still allow governments to provide CSOs to assist disadvantaged groups or areas.

CSO issues also arise under other NCP reforms:

- when examining anti-competitive legislation, reviews consider, among other things, “social welfare and equity considerations, including community service obligations”;
- governments also review any community service obligations provided by a government-run business when examining the merits of applying competitive neutrality reforms to that business. The Council noted in its 1997 publication, *Competitive Neutrality Reform* that the way governments identify, cost and fund CSOs are important competitive neutrality issues (NCC 1997c). There are a number of reasons for this. For example, failure to clearly identify CSOs and their funding could put a government supplier at a disadvantage in a competitive tender; and
- before privatising a public monopoly or exposing it to competition, governments are required to review, among other things, “the merits of any CSOs undertaken by the public monopoly and the best means of funding and delivering any mandated CSOs.”

In each case, it is open for reviews to recommend retention, increases or decreases to any CSOs provided by the government businesses under scrutiny and, where the CSO is to be retained, appropriate methods for its delivery.

Legislation review, competitive neutrality and structural reform issues all arose in the Council’s review of Australia Post (NCC 1998c). The Council’s report included twelve recommendations to maintain or strengthen existing community service obligations and to provide guarantees that services will be maintained. The Council also recommended that the method of delivery revert from cross-subsidy to transparent funding. The funding method preferred was budgetary allocation locked in for five years in legislation or, alternatively, an industry levy.

2.6 Effects on the environment

Over recent years, there has been a trend towards the integration of economic and environmental considerations into government decision-making. This trend is reflected in various aspects of the NCP package.

Water

Ecological sustainability is a central objective of NCP water reform – indeed, the Australian Conservation Foundation recently described the reform package as “ground-breaking.” (*Habitat Australia*, August 1998).

A key aim of water reform is for people and businesses to pay according to how much water they use, and for prices to cover the cost of supply. These pricing reforms will encourage people to think about the way they use water and promote better conservation. The water reforms also recognise the environment as a user of water, with a right to a share of water allocations in the same way as consumers and industry. This and several other measures are aimed at maintaining healthy river systems and groundwater basins in the future. Finally, the construction of new dams in future is only to be undertaken after appraisal indicates that it is both economically viable and ecologically sustainable.

NSW is one State to have initiated a number of reforms to address these issues in 1997 and 1998 (see Box 10).

In April 1998, rules were announced for seven key rivers which provide an increased share (within 10 percent) of average annual diversions for the environment. Some key targets for 1998-99 include increased opportunities for native fish breeding and migration, improving the frequency and success of bird breeding in wetland areas, suppressing algal blooms and exotic species, improving the health of in-stream ecology, and greater long term certainty of volumes and water quality for water users.

Box 10 Water reforms for the environment in NSW

The NCP water package requires environmental reforms such as recognising the environment as a legitimate user of water, establishing entitlements for the environment as a priority, and improvements in water quality.

To better balance river health and use, the NSW Government introduced water reforms in 1997 and 1998 that target sharing of water between the environment and consumers, and establish water quality objectives to provide certainty in water use rights and a better foundation for investment. The package also promotes community involvement in water management.

The NSW Government has released a stressed rivers assessment report which classifies all unregulated NSW rivers according to low, medium and high environmental stress. The Report aims to ensure that river health meets the needs of individual rivers and minimises the impact on the rural community.

The Healthy Rivers Commission (HRC) conducts public inquiries and reports to government on environmental requirements for coastal rivers, including long term river health objectives to balance the environmental, social and commercial goals for each river. The HRC has completed inquiries into the Williams River and the Hawkesbury Nepean river systems.

For all remaining rivers, NSW is in the process of setting interim rules and objectives. For regulated rivers, River Management Committees are developing environmental flow rules and water quality plans for each subcatchment for the next five years. Priority subcatchment plans covering stressed rivers, high conservation streams and rivers at risk of stress through activating sleeper water licenses are to be in place by 2000-01. An embargo on issuing new water licenses is also in place on regulated rivers in NSW.

Energy

One of the stated aims of electricity reform is to promote “the most efficient, economic and ecologically sound development of the electricity industry...” (SPC 1991). Clause 2(a) of the 1994 COAG Electricity Agreement further requires that the regulatory framework take account of the environment.

Overall, however, the NCP reforms in electricity and gas focus on improving the efficiency of energy markets, subject to *existing* environmental policies.

But the energy reforms may have a number of environmental impacts – both positive and negative. It is possible, for example, that the significant price reductions for energy flowing from NCP energy reform (see Box 2) could increase the total amount of energy demanded in Australia, thereby increasing the environmental impact of producing and supplying it.

Offsetting this, the energy reforms can provide important environmental benefits. For example:

- the creation of wholesale trading arrangements through a national electricity market allows suppliers to sell ‘green energy’ into the market and makes it easier for consumers to buy energy from renewable sources. A green energy market was launched in NSW in 1997;
- the gas reform package is expected to contribute to an expansion in natural gas consumption from its current 18 percent share of total energy consumption to about 28 percent by the year 2010, at the expense of black and brown coal and petroleum products (ABARE 1998). Natural gas emits less carbon dioxide per unit of energy than any other fossil fuel; and
- the introduction of national ‘access’ codes in gas and electricity will allow more efficient use of gas pipelines and electrical power lines, and discourage wasteful duplication of these facilities. The expansion of interstate trade in electricity also discourages unnecessary investment in new power stations by allowing States with deficient generating capacity to acquire any shortfall from those States with excess capacity.

Nevertheless, should it be determined that cheaper costs are leading to excessive expansion in energy use, governments would need to consider appropriate policy responses. For example, tradeable emissions rights is one approach that creates incentives for people to reduce their energy consumption. This in turn may facilitate the use of tighter emissions targets over time. The aim would be to marry the benefits of least-cost energy provision under NCP, with the benefits of least-cost pollution abatement using an appropriate policy tool. This aligns with ecologically sustainable development principles.

Other NCP reforms

The environment is an explicit consideration in the NCP public interest test and as such, is one of the matters to be weighed up when deciding whether to apply several of the NCP reforms. Specifically, clause 1(3) of the Competition Principles Agreement lists “government legislation and policies relating to ecologically sustainable development” as one of the issues for governments to take into account when assessing the merits of reforming anti-competitive legislation, applying structural reform to public monopolies and applying competitive neutrality to government businesses

Importantly, under the NCP agreements, environmental considerations enjoy intrinsically equal importance with other considerations, such as social and financial considerations.

For example, under the legislation review principles, anti-competitive legislation is to be retained if the benefits (including the environmental benefits) exceed the costs (including the environmental costs) of doing so, and if the legislation’s objectives cannot be attained in other ways. As an example, the 1995 review of the South Australian Water Resources Act found that while aspects of the Act are restrictive, they generate net benefits by mitigating the risk of environmental degradation. It therefore recommended that the restrictions be retained.

