Department of the Treasury

The Socio-Economic Consequences

of the

National Competition Policy

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Contents

Acronyms and Abbreviations

ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ACTO	Australian Cargo Terminal Operators
AP	Australia Post
ARTC	Australian Rail Track Corporation
CoAG	Council of Australian Governments
CCA	Conduct Code Agreement
CCNCO	Commonwealth Competitive Neutrality Complaints Office
CN	competitive neutrality
CPA	Competition Principles Agreement
CPRA	Competition Policy Reform Act 1995
CSO	community service obligation
FAC	Federal Airports Corporation
GBE	government business enterprise
HCFCs	hydrochlorofluorocarbon gases
HFCs	hydroflurocarbon gases
HoRSC	House of Representatives Standing Committee
IC	Industry Commission
IR	Industrial Relations
NCC	National Competition Council
NCP	National Competition Policy
NEC	National Electricity Code
NEM	National Electricity Market
NRTC	National Road Transport Commission
NSW	New South Wales
NT	Northern Terrritory
OH&S	Occupational Health and Safety
ORR	Office of Regulation Review
QCA	Queensland Competition Authority
QLD	Queensland
PSA	Prices Surveillance Act 1983
RAC	Rail Access Corporation

RIS	regulation impact statement
SA	South Australia
SMA	statutory marketing authority
TAS	Tasmania
the Code	The National Gas Access Code
TPA	Trade Practices Act 1974
US	United States
UK	United Kingdom
VIC	Victoria
WA	Western Australia

Executive Summary

This paper was originally prepared as the Treasury's submission to the Senate Select Committee on the Socio-Economic Consequences of the National Competition Policy (NCP) of the 38th Parliament. However, the 38th Parliament ceased before the paper could be formally received by that Committee as a submission.

In October 1992, the Commonwealth Government established a committee (the Hilmer Committee) to inquire into a NCP, following the agreement by Australian Governments on the need for such a policy. At the April 1995 Council of Australian Governments (CoAG) meeting, the Commonwealth, State, and Territory Governments agreed on a package of reforms based largely on the recommendations of the Hilmer Committee.

The NCP reform package is designed to improve the efficiency of the Australian economy, leading to lower prices for consumers and raised living standards. However, the package clearly acknowledges that economic efficiency arising from increased competition is not the only goal, and must be balanced against socio-economic factors, such as protection of the environment, employment and regional development. Therefore, a central element of the package is the recognition that the public interest must be taken into account in pursuing the reforms. That is, the reforms should result in a net public benefit, the assessment of which includes a range of socio-economic factors.

The NCP reforms are by no means the first competition reform measures undertaken in Australia. Prior to the introduction of the NCP package, many competition reforms were underway at a sectoral level, and Commonwealth trade practices legislation had been in place since 1965. However, the NCP reform package represents the first truly coordinated inter-governmental reform process. The reforms are broad ranging, and touch virtually every part of the Australian economy.

They impact on urban, regional and rural Australia. However, as would be expected, the reforms do not, and will not, necessarily impact to the same degree throughout Australia. Depending on the industry or sector concerned, the effects on urban, regional and rural communities may differ. For example, the nature or location of the industry may be more connected with a particular community, or jurisdictions may choose to implement reforms at different times and speeds. The public interest requirement also plays a major role in how, when, and to what extent reforms impact.

Unfortunately, the reform process will involve short-term transitional costs. The transitional costs of reform are often concentrated and readily apparent, whereas the long-term benefits are generally more diffuse and less obvious. Nevertheless, the public benefit requirements built into the NCP package are designed to ensure that any proposed reform benefits the community as a whole.

There are other factors, apart from the NCP reforms, which have an effect on urban, regional and rural communities. These factors include improvements in technology, trade policies, globalisation of financial markets, and demographic changes. The effects of these factors, particularly negative effects, are often mistakenly attributed to the NCP reforms, and while it is difficult to separate the effects of these factors from the impact of the NCP reforms, it is important to recognise they exist.

It is still relatively early days in the implementation of the NCP reforms, and quantitative evidence of their effects is relatively limited. However, the evidence that is available suggests the reforms are delivering benefits in the form of lower prices and greater choice not only for consumers, but also for business.

Treasury's role and aims in preparing this paper

The aims of this paper

Treasury supports public scrutiny of the competition policy reform process, and welcomes any opportunity for a reasoned assessment of the effects of competition policy reforms generally, and in particular on regional and rural Australia.

The NCP reforms are aimed at improving the living standards of all Australians. There is, unfortunately, some misunderstanding in the community regarding the purpose and likely effects of the reform package. For example, there is a lack of awareness of the role that public interest considerations play in competition policy (discussed in Section 5(c)). Such misunderstanding has led to negative perceptions in some quarters as to the value of the competition reforms. Hence there is a need to raise the level of awareness of competition policy and better explain the NCP reforms to the Australian public, and this paper is directed to this end.

The need for governments to better explain NCP has recently been expressed by the House of Representatives Standing Committee (HoRSC) on Financial Institutions and Public Administration in its review of the National Competition Council (NCC) 1996-97 Annual Report (June 1998). The Committee recommended:

> *'That the Commonwealth, State and Territory Governments and agencies involved in the implementation of NCP devote resources to ensure community understanding and debate about the contents of the policy and its outcomes.'*

Treasury notes that the Productivity Commission has received a reference from the Treasurer to report, by September 1999, on the impact of competition policy reforms on rural and regional Australia. Through the public inquiry process, and given its expertise in assessing the impact of government policies across the whole community, the Productivity Commission's findings will guide governments with future implementation of the NCP reforms and raise public awareness and understanding of NCP. However, we recognise that fostering awareness and understanding of NCP is an ongoing responsibility for governments.

Treasury's role in national competition policy

At the Commonwealth level, overall responsibility for competition policy lies with the Treasurer. The Treasury, therefore, has prime responsibility for advising on competition policy issues. Given the implementation of the NCP reforms involves a cooperative approach between the Commonwealth, States and Territories, Treasury has an active role in progressing the reforms; maintaining consistency in their implementation across jurisdictions and encouraging the continued commitment of all jurisdictions to the reform process.

Treasury is also responsible for advising the Treasurer on the administration of those parts of the *Trade Practices Act 1974* (TPA) which relate to competition matters, including the administration of the competition bodies established under the TPA, namely, the NCC, the Australian Competition and Consumer Commission (ACCC), and the Australian Competition Tribunal. In addition, Treasury leads Australia's participation in discussions on competition policy issues at international fora, such as the OECD and APEC. Finally, Treasury is actively engaged in advising the Treasurer on the maintenance of the linkages between the NCP reforms and the broader microeconomic reform process.

Other bodies, such as the NCC, ACCC, the Office of Regulation Review (ORR) and Commonwealth Competitive Neutrality (CN) Complaints Office (CCNCO) also have significant roles in the implementation of competition reforms. The roles of these bodies are discussed in Section Three.

As part of the NCP reform package, the Treasurer is responsible, on behalf of the Commonwealth, for making 'Competition Payments' to the jurisdictions participating in the competition reform process (currently all States, the Northern Territory (NT) and the Australian Capital Territory (ACT)). These payments are tied to the progress made by the participating jurisdictions in implementing the NCP and related reforms. In deciding whether, and to what extent, to make these payments, the Treasurer is advised by the NCC.

What is competition policy?

Competition policy encompasses a broad range of policy actions aimed at promoting competition in the economy. It covers business conduct, market structure and regulation. It can also, in a wider sense, encompass issues such as tariff policy and IR. The NCP reform package, however, is not that broad and is focused on the following:

- the extended application of competitive conduct rules;
- reform of regulation which unjustifiably restricts competition;
- reforming the structure of public monopolies to facilitate competition;
- providing third-party access to significant infrastructure facilities;
- prices oversight of government business enterprises (GBEs); and
- pursuing CN between government and private businesses when they compete.

Some of these elements involve moving to less or simpler regulation; others have required, or indicate the need for, additional regulation.

The overall aim of competition reform is to improve the efficiency of resource use and hence maximise the community benefits of economic activity. This 'efficiency' extends beyond a narrower sense in which the *most appropriate* range of goods and services are produced *at least cost*, although it encompasses this. It also involves the impact that competition has on the dynamics of economic growth. Competition provides a spur to innovation in product design, production processes and management practices. As such, it underpins much of the developmental process within a mixed economy like Australia's and is fundamentally involved with processes of change. Change, however, has many facets. Along with the benefits it can deliver, it can also create difficulties for individuals and the need for significant adjustment by the community; and it therefore needs to be appropriately managed.

While the NCP might be considered to date from the signing of the inter-governmental competition policy agreements in April 1995 (see Section Three), competition reforms go back much further. The TPA was passed in 1974, replacing even earlier Commonwealth legislation also aimed at protecting the community from the costs of non-competitive behaviour. Likewise, the corporatisation of GBEs preceded the Competition Principles Agreement (CPA). Since the early to mid-1980s, both Commonwealth and State governments have been corporatising their GBEs, bringing them more into line operationally with practice in private markets, with the purpose of lifting them from low productivity levels and poor returns on capital

investment[1]. Accordingly, NCP does not represent a major change of direction in microeconomic reform, although it encourages an acceleration of reform in some areas.

Economic context

More broadly, the impact of competition policy reforms — and microeconomic reform more generally — can be viewed in the context of a history of ongoing structural changes to the economy, requiring adjustment from businesses and employees, and from governments and the general community. The international economy and associated trading patterns have changed greatly over the post-war decades; technological advances have had an enormous impact; and these factors — as well as others — have led to substantial changes in the sectoral composition of Australia's output and employment. For example, agriculture accounted for around 9 per cent of the Australian workforce in 1966; thirty years later, in 1996, this was down to about 5 per cent. During the same period, employment in service industries moved from about 56 per cent of the workforce to 73 per cent.[2]

Pressure to improve the operation of all parts of the economy has mounted over the last three decades. The increased international exposure of the Australian economy has raised pressure on Australian firms to lower costs, not only with respect to their own productive processes but also for their inputs, such as services from utilities and other infrastructure, which may not be exposed to international competition. Pressure has also come from the low productivity growth rates Australia experienced in the 1970s and 1980s relative both to previous decades and to those of other developed countries. Productivity growth is the main driver of higher material living standards[3] and provides the resources to improve other aspects of community well-being such as welfare services and environmental protection.

Such developments have increased pressure on Australian governments to extend competitive practices in the economy. Competition is a powerful tool in encouraging suppliers to seek out more effective and efficient ways of providing their goods and services. It was in this context that the Commonwealth, State and Territory governments agreed in 1992 to commission the report of the Independent Committee of Inquiry into a NCP (known as the 'Hilmer' report).

In 1993, the Hilmer Committee reported that poor productivity performance of Australia's infrastructure industries was one of the factors which kept Australia's per capita growth below the OECD average during the three decades to the early

1 S.P. King, 'National Competition Policy', *The Economic Record*, vol 73, no 222, September 1997.
2 Australian Bureau of Statistics, *Labour force survey*, 6203.0.
3 It is estimated that productivity growth has accounted for about two-thirds of the improvement in the average real incomes of Australians over the past three decades. Refer IC, *Assessing Australia's Productivity Performance*, September 1997.

1990s[4]. Hence, the Hilmer Committee recommended, and governments agreed to, the establishment of a nation-wide approach to competition policy.

Given developments that were occurring already and the pressures described above, it seems clear that competition reform would have progressed in the absence of a NCP. Indeed, competition reform is a response to the ongoing process of structural change. A national policy serves to develop the competition reform process within a cohesive and consistent framework between the Commonwealth, States and Territories and across sectors of the economy. This facilitates its progress and increases its effectiveness. For instance, it encourages infrastructure reforms to be progressed on several jurisdictional fronts at the same time, as has happened with the development of a National Electricity Market (NEM). A national approach for business regulation is also advantageous in an environment where Australian business is increasingly operating on a nationally integrated basis.

Complementarity of competition regulation and structural reform

The existence of legislation (such as the TPA) to curb anti-competitive behaviour by firms is a crucial element of competition policy. However, competitive behaviour also depends on the structure of markets and the incentives created in those markets to foster pro-competitive outcomes. Therefore, concomitant to such legislation, a broader competition policy is required, embracing structural reforms such as reducing barriers to entry and exposing government-owned businesses to competitive market forces. Without such structural reforms, there is no guarantee that legislation and regulation would deliver competitive market outcomes.

Legislation and regulation, by their very nature, cannot be as dynamic as highly competitive market structures. Regulatory solutions may not cover the full range of anti-competitive behaviour; bodies set up to administer regulations face problems in actually monitoring market behaviour; and the legislative sanctions may not provide strong enough incentives to market players to act in a competitive way.

It is important, however, that a regulatory framework complement structural reforms aimed at promoting competition. The regulatory framework plays a key role in competition policy, operating as a mechanism to prevent anti-competitive conduct in situations where the market structure, by itself, is not sufficient to do so. An example of the application of this principle is that the ACCC is less likely to intervene in a merger between two domestic firms where there is effective competition in the industry from imports, or the potential for such import competition to operate. Also, prices oversight may be an important regulatory tool of competition policy in industries where competition is lacking. For example, in the Australian context it is difficult to avoid airports having monopoly characteristics; therefore, some form of

4 Report by the Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, 1993.

price capping for airport services is appropriate. The regulatory and structural elements of competition policy complement each other to provide a comprehensive approach to promoting competition.

Public perceptions of competition policy

It is often difficult to distinguish the impact of NCP reforms from other factors. Other areas of microeconomic reform, technological change, changing consumption patterns (notably the trend for services to account for a higher proportion of consumer expenditure), demographical changes (such as the reduction in population in some rural areas) and developments in business practices have all had an impact on the community.

Reforms to public sector management are also impacting on many areas where NCP is being applied. During the past decade many agencies and GBEs have undertaken substantial reform of their operations in an effort to improve their services and reduce costs. In some cases, exposure to competitive pressures from the application of NCP is providing an added impetus for management reform but, even without NCP, substantial reform of public sector agencies and business could be expected.

In some cases, reform of the public sector has involved the privatisation of publicly-owned assets. There has also been increased competitive tendering for the provision of public services. While these changes have sometimes been associated with the application of NCP, they are not required by the inter-governmental competition policy agreements.

Because these other factors are working concurrently with the NCP, there appears to be some blurring in public perceptions between changes flowing from the NCP and what can be attributed to other influences. Indeed, even with a more careful analysis it can sometimes be difficult to disentangle causative factors. This problem of isolating and assessing the causes of socio-economic changes is evident across the country, but appears to be particularly the case in rural and regional areas.

There also appears to be some public misunderstanding regarding other aspects of the NCP. Contrary to some suggestions, the NCP allows for the continuation of pricing arrangements under which rural and other consumers are provided services at less than full cost. These can be provided under community service obligations (CSOs) imposed by governments on service providers on public interest grounds. (A more detailed discussion of CSOs is provided in Section 5(a)).

Nor is it the case that implementing NCP reforms will lead to the wholesale dismantling of the public sector. The reforms are relevant only to 'significant' business activities undertaken by governments and would not be generally relevant to such sectors as education, health and welfare services.

Costs and benefits

The purpose of competition policy is to improve the welfare of the Australian community by increasing the efficiency of the Australian economy. It aims to encourage providers of goods and services to offer consumers and other businesses the most appropriate mix of products at lower prices and/or improved levels of quality. By increasing efficiency, competition policy expands the productive capacity of the Australian economy, and thereby not only raises real incomes but also increases the material means by which other social objectives, such as improved community services (eg, health and education) and higher environmental standards, can be met.

A lack of competition can, on the other hand, lead to undesirable consequences such as inflated prices, reduced production, less consumer choice, inefficient work practices, wasted materials and poor management.

The application of competition policy principles has already led to increased productivity and lower prices in a number of areas such as telecommunications and electricity supply and, more broadly, competitive pressures have contributed to the low inflation that Australia has experienced in recent years. By increasing competition between producers, an effective competition policy promotes lower prices, benefiting consumers either directly or indirectly through lower cost inputs to other businesses. Where a competitive structure is not appropriate or possible, competition policy can reduce the price effects of monopolies through regulatory price oversight.

Inflation has, in the past, acted as a constraint on the ability to maintain high economic growth. By increasing the productivity of resources, such as labour and capital, competition policy helps to raise the capacity of the economy. That is, the economy is able to achieve higher growth rates before inflationary pressures mount.

By facilitating relative price adjustments and encouraging initiative and innovation, effective competition also increases the ability of the economy to respond to external shocks and changing market opportunities.

It needs to be emphasised that while competition policy aims to promote efficiency and economic growth — because of the pay-offs they provide for community welfare — it also accommodates situations where competition conflicts with other social objectives. The CPA explicitly provides for a range of social, environmental, regional and equity criteria to be taken into account in addressing the public interest. Governments can choose not to implement the NCP reforms if, taking such criteria into account, costs are objectively judged to exceed the benefits.

Like other areas of microeconomic reform, the gains from competition reform are often dispersed among the community and are frequently received down the track while the costs tend to be felt by concentrated groups of people and occur up-front. As discussed above, there are mechanisms for ensuring the aggregate gains exceed

the aggregate costs. However, it will often seem otherwise as the costs are often more visible and immediate.

Nonetheless, whatever the aggregate net benefits, the impact of reform on individual firms or groups will vary. While competition reform can be expected to enhance growth in industries and regions which benefit from the cost reductions generated by reform, some will inevitably not be as well off.

In such circumstances, it is appropriate for the broader community to assist individuals and groups that are adversely affected. The increased national income generated over time by reform provides greater scope for such assistance measures.

As described above, competition policy has been developed in response to pressures to reduce unwarranted costs in the economy. These pressures will continue to exert themselves, and will mount if not responded to. Countries which have resisted structural change have often found that forces eventually dictate that they *do* undertake reform. However, by delaying, the adjustments may involve large shifts over a smaller timeframe. This is usually more disruptive and more costly to society. By being responsive earlier, the reform process can be more staged and costs thereby lessened.

A comprehensive and co-ordinated approach to reform can also facilitate the adjustment process. Undertaking competition reform on a broad front, and in conjunction with other areas of microeconomic reform, will ensure a wide distribution of the costs and benefits across the community. Where specific individuals and industries find that they are negatively affected by change from one direction this can be offset, at least partially, by changes in other areas that affect them positively.

Australia's current competition policy framework

At the April 1995 CoAG meeting, the Commonwealth, the States, the NT and the ACT agreed to implement a NCP along the lines recommended by the Hilmer Report. The NCP package consists of:

- three inter-governmental agreements — the Conduct Code Agreement (CCA), the CPA, and the Agreement to Implement the NCP and Related Reforms;
- the *Competition Policy Reform Act 1995* (CPRA); and
- State and Territory application legislation.

The Inter-governmental Agreements

CCA

The CCA evidences the agreement of the States and Territories to apply the competitive conduct rules in Part IV of the TPA (as well as other provisions and regulations of the TPA so far as they relate to Part IV) in their respective jurisdictions. The competitive conduct rules as applied by the States and Territories are referred to in the CCA as the Competition Code. An outline of the provisions of Part IV of the TPA and the mechanism by which it is extended are set out below under the discussion on the legislation.

In order to ensure the continuing consistency of application of the Competition Laws (which is defined as Part IV of the TPA and related provisions, and the Competition Codes of the States and Territories), the CCA sets out a consultation and voting process to be followed where the Commonwealth wishes to make modifications.

The CCA outlines the process by which exceptions to the operation of Part IV of the TPA, or the Competition Code of a State or Territory, may be made by Commonwealth, State or Territory laws. The exception mechanism itself is set out in section 51 of the TPA, and is described further below under the discussion on the legislation.

The CCA also sets out a process for appointments to the ACCC, including a requirement that the States and Territories be consulted. They may put forward nominees for vacancies on the ACCC. The support of a majority of States and Territories is required before an appointment can be made.

CPA

The CPA commits the Commonwealth and the States and Territories to a number of specific reforms.

Prices Oversight of GBEs

The general principle is that prices oversight of State and Territory GBEs should be conducted by the relevant State or Territory that owns the GBE. The NCC has the function of assisting parties to the CPA to examine issues relating to prices oversight of GBEs. The States and Territories are encouraged to establish *independent* prices oversight bodies, where they do not already exist. To date, such bodies have been established by all States and Territories other than Western Australia (WA) and the NT.

The ACCC administers prices surveillance under the Commonwealth *Prices Surveillance Act 1983* (PSA). The PSA will apply to State and Territory GBEs where the State or Territory concerned has agreed, or where the relevant Commonwealth Minister declares the business to be subject to the PSA. A State or Territory GBE cannot be declared unless the NCC, at the request of a jurisdiction, has recommended 'declaration' of the GBE on the basis that it is not subject to effective oversight, and the jurisdiction lodging the request is adversely affected by this lack of oversight and has been unable to resolve the matter with the jurisdiction that owns the GBE in question. Before recommending declaration the NCC must also be satisfied that the pricing of the GBE in question has a significant direct or indirect impact on constitutional trade or commerce. The relevant Commonwealth Minister must consult with the appropriate Minister of the State or Territory that owns the GBE prior to declaring the GBE to be subject to prices oversight under the PSA. To date no applications have been made to the NCC to declare a State or Territory GBE.

CN Policy and Principles

The parties to the CPA have agreed to abide by CN principles. The objective of CN policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities — that is, Government businesses should not enjoy any net competitive advantage or disadvantage simply due to their public ownership. Each party is free to determine its own agenda for the implementation of CN principles and may seek assistance from the NCC.

In order to neutralise any net competitive advantage, the CPA sets out a number of possible measures: corporatisation, imposition of full taxes (or tax equivalents), debt guarantee fees, and imposition of regulation on an equivalent basis to the private sector. However, the imposition of these CN principles is only required to the extent that the benefits realised from their implementation outweigh the costs.

While not specifically referred to in the CPA, jurisdictions have recognised that it is consistent with CN principles that government-owned businesses also be required to earn commercial rates of return on assets, and to pay commercial dividends (ie, equivalent to the average for their industry) from those returns.

Importantly, however, the CPA explicitly states that it is neutral with respect to the nature and form of ownership of business enterprises, and does not promote public or private ownership.

As required under the CPA, all parties published policy statements on CN by June 1996. They are also required to publish annual reports on the implementation of the CN principles, including claims of non-compliance. At the Commonwealth level, the Commonwealth CCNCO has been established within the Productivity Commission to receive and report on complaints relating to non-compliance with CN principles (including complaints from government businesses themselves that they suffer competitive disadvantages). The States and Territories have also established complaints mechanisms.

An example of a CN complaint is set out in Box 3.1.

Box 3.1: Case study — New electricity infrastructure in Wide Bay-Burnett, Queensland (QLD)

In February 1998 the QLD Competition Authority (QCA) delivered one of Australia's first reports on a CN complaint.

The Wide Bay-Burnett Electricity Corporation distributes electricity in regional and rural QLD in the Bundaberg area. A developer lodged a complaint alleging that the Corporation partly protected its own construction business from private sector competition when extending its electricity distribution network to new properties.

When a property developer in the Wide-Bay area or the builder of a new house on rural land wants to link to the electricity distribution network the Corporation provides an estimate of how much it would cost to build a link to the network. The developer can then choose to do the work or sub-contract it, in which case the Corporation pays the developer the estimated cost. lternatively, the developer can elect to have the Corporation perform the work.

The QCA found that overall the Wide Bay-Burnett Electricity Corporation did favour its own design and construction unit by setting cost estimates that are too low to cover:

- sales taxes,
- a share of the Corporation's corporate overheads; and
- a provision for normal profit.

Continued …

Amongst other advice the QCA recommended that the Corporation should include these factors above in future cost estimates and the relevant QLD Ministers accepted the QCA's recommendations.

Source: QCA, Complaint by Robin Russell and Associates against the Wide Bay-Burnett Electricity Corporation — Findings and Recommendations, February 1998.

Structural Reform of Public Monopolies

Parties to the CPA agreed to abide by various principles in the reform of public monopolies. Before introducing competition into a sector traditionally supplied by a public monopoly, parties have agreed to remove from the public monopoly any responsibility for industry regulation, and to relocate industry regulation functions so as to prevent the former monopolist enjoying any regulatory advantage over its rivals.

Also, before introducing competition into a market traditionally supplied by a public monopoly, (and before privatising a public monopoly), parties agreed to undertake a review into a range of matters, including:

- the appropriate commercial objectives of the business;
- the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;
- the merits of separating potentially competitive elements of the public monopoly;
- the CSOs undertaken by the public monopoly;
- the regulation to be applied to the industry; and
- the ongoing financial relationships between the owner and the public monopoly.

Each party is free to determine its own agenda for the reform of public monopolies, and may seek assistance from the NCC in conducting reviews for this purpose. As mentioned above, the NCP reform package does not compel privatisation of government-owned businesses, nor does it require governments to remove or reduce the CSOs of those businesses. The decision as to whether and, if so, when such a business might be privatised remains the exclusive responsibility of the government owner.

Legislation Review

Under the CPA, each party agreed to review and, where appropriate, reform all existing legislation that restricts competition by the year 2000. All legislation will then be reviewed at least once every ten years. The rationale underlying this commitment is that such reviews will provide a transparent, objective assessment of

the costs and benefits of the relevant legislation to the broader community, as opposed to narrow groups that may have a vested interest in the legislative restrictions.

As required by the CPA, by June 1996 each party published a timetable for the review of anti-competitive legislation within their respective jurisdictions. In total there are close to 2000 pieces of legislation scheduled to be reviewed, approximately 100 of which are Commonwealth legislation.

The guiding principle for the reviews is that legislation should not restrict competition unless it can be demonstrated that:

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

Each party also has to ensure that proposals for new legislation that restricts competition are accompanied by evidence that the legislation is consistent with the above principle.

At the Commonwealth level, proposed new regulation (which includes primary and delegated legislation) which will directly affect business, or which will have a significant indirect effect on business, or which will restrict competition, requires the preparation of a regulation impact statement (RIS). A RIS is to be prepared by the agency or department developing a particular policy proposal, and is designed to assess the costs and benefits of each option available to realise the policy objective (including non-regulatory options). The ORR assists in the preparation of RISs and reports on compliance with RIS procedures. The ORR publication *A Guide to Regulation* provides further detail on the RIS process. Similarly, terms of reference for reviews of existing regulation must be approved by the ORR.

Where a party considers a review has national implications for competition, it may consult other interested jurisdictions on whether the review should be conducted on a national basis. If a national review is considered appropriate, the party proposing the review may, but is not obliged to, request the NCC to conduct the review.

While not limiting the terms of reference of a review (national or otherwise), it should:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- assess and balance the costs and benefits of the restriction; and
- consider alternative means for achieving the same result, including non-legislative approaches.

Each party is required to produce annual reports on its progress towards achieving its timetable for review, and the NCC is required to publish annual reports consolidating the parties' annual reports.

An example of a legislative review is shown in Box 3.2.

Box 3.2: Case study — Shopping hours in the ACT

In 1996, to assist suburban shopping centres, the ACT introduced legislation that restricted shop trading hours in major shopping centres. In 1997 an assessment of the legislation, supported by survey evidence, indicated that the public benefits of the legislation did not outweigh the costs.

The legislation was not very effective in promoting the fortunes of the small shopping centres and it imposed significant costs, including inconvenience and congestion for shoppers.

The legislation restricting trading hours in major shopping centres was repealed in May 1997.

Source: Market Attitude Research Services, Survey of Shopping Patterns and Attitudes towards ACT Shopping Hours, February 1997.

Access to Services Provided by Means of Significant Infrastructure Facilities

Access to certain key infrastructure facilities, such as electricity grids or gas pipelines, is recognised in the NCP as being important in order to encourage competition in related markets, such as electricity generation or gas production/distribution. A new electricity generator, for example, cannot compete with existing generators unless it can access the electricity grid.

Such facilities often display natural monopoly characteristics and it is not efficient to promote competition in related markets by duplicating the facility. If the facility can be separated from other arms of a business and established as a 'stand alone' business then the issue of access to the facility will be less of a problem since the owner of the facility will have an interest in maximising its use and profitability. However, such structural separation of the monopoly facility may not always be possible. In such cases, regulated provision of third party access to the facility may be appropriate.

Accordingly, a new Part IIIA was inserted into the TPA to establish a legislative framework for third parties to gain access to services provided by facilities or infrastructure of national significance. The CPA sets out criteria under which a State or Territory may establish its own access regime covering a facility in its jurisdiction. If the criteria are met, the NCC may recommend to the Commonwealth Minister (the Treasurer) that the regime be certified as 'effective'. If so certified, the services

subject to the regime are not subject to the 'declaration' process under Part IIIA of the TPA (see further discussion below under the legislation heading).

Application of the Principles to Local Government

The parties have agreed to apply the reforms set out in the CPA to local government, even though the local governments themselves are not parties to the agreement. Where the States and Territories are permitted to determine their own agendas for implementing the reforms (ie, in relation to CN, structural reform of public monopolies and legislation review) they agreed to publish a statement, prepared in consultation with local government, specifying the application of the principles to particular local government activities and functions. All States and Territories published these statements by June 1996.

Public Interest under the CPA

It is recognised in the NCP principles that competition is not an end in itself but rather a means of improving living standards for the Australian community. Hence, the CPA adopts a broad approach, setting out other factors to be taken into account in weighing the costs and benefits of various reforms, including:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including CSOs;
- government legislation and policies relating to matters such as occupational health and safety (OH&S), industrial relations (IR) and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian business; and
- the efficient allocation of resources.

The NCC

Apart from the above reform principles, the CPA also sets out a process for appointments to the NCC, including a requirement that all parties be consulted on such appointments. The parties may put forward nominees for vacancies on the NCC, and the support of a majority of States and Territories is required before an appointment can be made. The CPA also establishes the work program of the NCC, and a mechanism for the referral of matters to the NCC. The parties will review the need for, and the operation of, the NCC after it has been in existence for five years.

Agreement to Implement the NCP and Related Reforms (Implementation Agreement)

In recognition of the States and Territories agreeing to implement the NCP reform package and associated reforms in electricity, gas, water and road transport, and the substantial revenue gains the reforms are expected to provide, they are to receive 'Competition Payments' from the Commonwealth. The criteria for receiving, and the mechanism for making, these payments are set out in the Implementation Agreement.

In essence, there are three tranches of Competition Payments — commencing in 1997-98, 1999-2000, and 2001-2002 respectively. Prior to each tranche, the NCC is required to assess whether the conditions for payment have been met. These conditions are:

- for the first tranche
  - — that the jurisdiction has given effect to the inter-governmental agreements and, in particular, has met the required deadlines in relation to regulation review and CN;
  - — effective implementation of all CoAG agreements on electricity arrangements and the framework for free and fair trade in gas; and
  - — effective observance of road transport reforms.
- for the second tranche
  - — the same as for the first tranche, with the addition of the requirement for the effective implementation of all CoAG agreements on the strategic framework for the efficient and sustainable reform of the Australian water industry.
- for the third tranche
  - — continued observance and adherence to the conditions for the first two tranches (including all CoAG agreements relating to electricity, gas, water and road transport).

The NCC reports to the Treasurer on whether the conditions for payment have been met and recommends whether, and to what extent, the Commonwealth should make the payments. The final decision rests with the Treasurer.

Following its June 1997 assessment, the NCC recommended the States and Territories be subject to a supplementary assessment against their first tranche commitments, to be undertaken in June 1998. This provided an alternative to recommending the imposition of financial penalties for unsatisfactory performance in various areas. This approach was accepted by the Treasurer, resulting in partial payments being made in 1997-98.

In its June 1998 supplementary assessment, the NCC recommended that all States and Territories, other than NSW, receive the full amount of their remaining first tranche Competition Payments. In relation to NSW the NCC recommended that

$10 million be deducted from its payment if domestic rice marketing arrangements are not reformed by 31 January 1999 — as recommended by an independent review group in 1995. The Treasurer generally accepted the NCC's recommendations. In relation to NSW, the Treasurer decided to delay until early 1999 any decision on whether that State would have its 1998-99 Competition Payments reduced.

Related Reforms

Reform in certain industries had already commenced prior to the agreement upon the NCP reform package at the CoAG meeting in April 1995. In particular, in relation to gas, electricity, water and road transport, previous CoAG meetings and Premiers' Conferences had agreed upon a process of reform. The reform programs relating to these industries were brought within the NCP framework by linking their satisfactory progress to the Competition Payments under the Implementation Agreement as mentioned above. Details of the reforms in these industries are set out in Section Four.

The Legislation

The Competition Policy Reform Act (CPRA)

The CPRA made amendments to the TPA and the *Prices Surveillance Act 1983* (PSA) and provided a mechanism for the States and Territories to apply the competition provisions in Part IV of the TPA (and provisions that relate to Part IV) to areas of business activity not previously covered by Part IV.

The major elements of the CPRA are:

- the ACCC was established to take over the functions of the former Trade Practices Commission and the Prices Surveillance Authority. The CPRA also conferred additional functions on the ACCC under the third party access regime inserted into the TPA (see below).
- the NCC was established as an independent advisory body for all governments involved in implementing the competition reforms. The NCC has a role in assessing governments' progress in implementing the NCP reforms; making recommendations in relation to third party access and pricing matters; and other work as agreed upon by a majority of the participating governments.
- prices monitoring powers in the PSA were formalised, and potentially extended to apply to State and Territory-owned businesses.
- a new Part IIIA was inserted into the TPA to set up a regime under which third parties can seek access to services provided by facilities which are of national significance (essentially aimed at 'natural monopoly' type infrastructure such as gas pipelines, electricity grids etc). In brief, access can arise where:

- — a person seeking access applies to the NCC to recommend that the service be 'declared' by the relevant Commonwealth, State, or Territory Minister. Certain criteria must be met before the NCC can recommend declaration, and the Minister, after considering the same criteria as the NCC, is free to accept or reject the NCC's recommendation (but must give reasons). If declared, the access seeker and the service provider are required to negotiate terms and conditions of access, with an arbitration process being available to resolve any disputes;
- — a State or Territory establishes an access regime to apply to services provided by facilities in their respective jurisdictions. If the Commonwealth Minister certifies the regime as 'effective' (following a recommendation from the NCC), that regime will govern the terms and conditions of access to the services covered;
- — a service provider lodges a voluntary undertaking with the ACCC, which may set out the terms and conditions on which access will be granted.

Detailed information on the access regime in Part IIIA can be found in the NCC publication *The National Access —A Draft Guide to Part IIIA of the Trade Practices Act* (August 1996).

- ♦ the competitive conduct rules in Part IV of the TPA were amended and their application extended. The provisions in Part IV prohibit various forms of anti-competitive conduct including:
  - — contracts, arrangements or understandings that restrict competition;
  - — boycott and secondary boycott activities;
  - — misuse of market power;
  - — exclusive dealing arrangements;
  - — resale price maintenance; and
  - — acquisitions that lessen competition.

Prior to the passing of the CPRA these provisions were limited in their application, corresponding, in part, to the limited powers of the Commonwealth under the Constitution. Essentially, while Part IV applied to corporations and Commonwealth Government instrumentalities in so far as they carried on a business, it did not generally apply to individuals and unincorporated businesses, nor to State or Territory government-owned businesses.

The CPRA removed the 'Shield of the Crown' immunity for the States, the NT and the ACT. That is, it made those governments, in so far as they carry on a business, subject to Part IV of the TPA.

The CPRA also provided a mechanism for the States and Territories to apply Part IV in their respective jurisdictions. This was achieved by adding a Schedule to the TPA that essentially reproduces Part IV, but extends its application not only to corporations, but also to unincorporated businesses. The States and Territories took

up this Schedule version of Part IV under their own application legislation, thus ensuring that the competitive conduct rules in Part IV apply to all businesses.

Implementation

The provisions of the CPRA took effect in stages. The amendments to the competitive conduct rules and the enactment of the Schedule version of Part IV of the TPA came into effect on 17 August 1995. The provisions establishing the ACCC and NCC, those establishing the access regime in the TPA, and those extending the PSA to apply to State and Territory government-owned businesses came into effect on 6 November 1995. The provisions extending the application of Part IV of the TPA to State and Territory business activities came into effect on 20 July 1996.

Transitional Arrangements

Given that the CPRA and the State and Territory application legislation resulted in conduct previously outside the scope of the competitive conduct rules being subject to those rules, certain transitional arrangements were put in place.

In particular, the mechanism for Commonwealth, State or Territory law to except conduct from the operation of the competitive conduct rules in the TPA was made more rigorous by the CPRA. Therefore, such laws current at the time the CPRA was passed were protected for three years (ie, until 20 July 1998). This gave jurisdictions the opportunity to review existing exceptions and, if necessary, seek to renew them using the amended mechanism in section 51 of the TPA, which provides that:

- excepting laws must expressly refer to the TPA and explicitly authorise the specific conduct sought to be excepted;
- exceptions from the acquisitions provision of the TPA (section 50) may only be made by a Commonwealth Act;
- exceptions made by subordinate regulations will only be effective for two years and cannot be extended;
- only those States and Territories that continue to participate in the co-operative arrangements (ie, continue to be a party to the inter-governmental agreements) may make such exceptions;
- exceptions made by States and Territories may be overridden by the Commonwealth (as was the case before the CPRA was passed); and
- excepting laws must be notified to the Commonwealth (via the ACCC, which will publish a list of exceptions in its Annual Report).

State and Territory Application Legislation

As mentioned above, the competitive conduct rules in Part IV of the TPA were extended to apply right across the economy by means of the creation of a Schedule

version of Part IV of the TPA, which was then applied by each of the States and Territories that are parties to the NCP reform package. This Schedule version applies Part IV not only to corporations, but also to unincorporated businesses.

The State and Territory application laws came into operation 12 months after the CPRA received the Royal Assent (ie, on 20 July 1996). In the case of WA, the legislation was not actually passed until September 1996, but was made to apply retrospectively from 20 July 1996.

Progress in major areas of reform

This section describes the progress that has been made in major areas of reform. The emphasis is on reform within the NCP framework but other related competition reforms are also discussed because they are based upon similar principles to NCP.

Overall, there has been substantial competition reforms over the last decade. However, the pace of reform has varied between industries and jurisdictions. Some NCP reforms are still being implemented, while many areas are still to be reviewed.

Telecommunications

Substantial reforms to the telecommunications industry have taken place over the past decade. These have seen the separation of regulatory functions from service provision, the recognition that previous monopolies for some telecommunications services have been eroded, the graduated entry of new players and the progressive opening of the market to full competition (with a supporting regulatory regime to sustain the competitive process). While the industry began its transition prior to the implementation of the NCP, the reform principles applied to the industry are broadly consistent with those advocated by NCP.

In 1989 Telecom (now Telstra) was corporatised with an independent board of directors, and an independent telecommunications regulatory body, AUSTEL, was established. Limited competition was permitted for value-added services (ie, reselling services using Telstra's network) and for installing and maintaining customer premises equipment.

From 1991, competition in all telecommunications services was introduced, with two carriers competing in the fixed services market (Telstra and Optus) and three players contesting the mobile telecommunications market (Telstra, Optus and Vodafone). Service providers could offer basic telecommunications services on the carriers' networks. During this period the pay TV market was opened to limited competition.

The most recent phase in telecommunications reforms began in July 1997 when the market was opened to full competition. There are no longer any limits on the number of carrier licences that may be issued, and a regulatory framework has been enacted that promotes efficient competition in the industry. Regulatory responsibility for competition now rests with the ACCC. General trade practices law now governs the competitive conduct of carriers along with additional powers for the ACCC to respond to instances of anti-competitive conduct. In addition, there is an industry specific access regime which aims to maximise the long term interests of

end-users by: promoting competition; ensuring calls originated in one network can be completed in other networks (any-to-any connectivity); and promoting the efficient use of, and investment in, telecommunications infrastructure.

Postal Services

Australia Post (AP) was corporatised in 1989 and service levels and efficiency have been improving markedly in recent years. A central issue in postal reform has been the need to balance the efficiency gains from introduction of competition with the requirement for AP to maintain its CSOs and provide a standard letter service at a uniform rate for all Australians. Following changes introduced in 1984, approximately 50 per cent of AP's revenue is contestable (mainly parcels and express mail) but AP has an effective monopoly on standard letters because competitors are not permitted to carry standard letters unless they charge at least $1.80 per item.

On 16 July 1998, the Government announced its postal reform package, following the release of an NCC review report. The NCC reviewed the remaining restrictions on competition in the postal services market as part of the Commonwealth Government's commitment under the CPA's legislation review principles.

A key feature of the Government's package is that the standard letter rate will remain frozen at 45 cents until at least 2003. As well, it provides an undertaking that no regional and rural post offices or mail centres will close as a result of the package and continues subsidies to Licensed Post Offices in country areas. The package also includes increased competition in the postal market from 1 July 2000 through reducing APs regulated monopoly over letters and allowing open competition in international mail. A review is to be completed by 2003 to assess the effects of these changes and the need for further change. Legislation has not yet been introduced to give effect to these reforms.

Electricity

The underlying philosophy in electricity reform has been to move away from an industry characterised by vertically integrated monopoly suppliers in separate State markets. The broad objective has been a more contestable structure involving a national market in eastern and southern Australia with generators competing to supply into the pool and customers able to choose from competing retailers for supply of their needs.

In June 1993, Commonwealth, State and Territory governments agreed to work cooperatively to establish a competitive NEM to commence from July 1995. Governments also agreed to implement other structural reforms which involved most jurisdictions corporatising and separating their vertically integrated utilities into generation, transmission and distribution businesses. At the April 1995 CoAG meeting, the reforms were extended and brought within the NCP process. There has

been some slippage in meeting the original NEM timetable because of technical problems associated with getting the market underway. The NEM is to evolve in stages, with full implementation of the arrangements now expected to commence in late 1998.

The first stage of the NEM commenced in May 1997. This linked the wholesale markets of New South Wales (NSW), the ACT and Victoria (VIC), allowing trade in electricity between these jurisdictions for the first time.

The new arrangements are based on the separation of industry sectors to allow: competition at the generation and retail levels; a wholesale electricity spot market; non-discriminatory access to the interconnected networks; eligible customers to choose who supplies their electricity; and the availability of financial instruments which will allow market participants to manage their risk exposure to spot prices.

The next stage of the NEM will involve the transfer of responsibilities for operation of the electricity market from the States and Territories to the NEM Management Company which will run a central wholesale electricity market in accordance with the National Electricity Code (NEC). The NEC Administrator will administer the Code and regulate the market and access regime.

South Australia (SA) will become a full participant in the market at the time of full commencement of the NEM. QLD will be an isolated participant in the NEM until an interconnector is completed between QLD and NSW, expected to occur in 2001.

Gas

Until recently, legislation in some States restricted the flow of natural gas within and beyond State boundaries (for example, by requiring approval for the sale of gas in excess of particular amounts). Such restrictions were generally intended to avoid the risk of possible gas shortages, or to ensure that gas was available to underpin industrial development within a State. In addition, market arrangements were characterised by very little competition in the delivery of gas, with a single production joint venture generally providing a State's entire gas needs via a dedicated pipeline to a single gas retailer.

At the CoAG meeting in February 1994, jurisdictions resolved to develop a nationally integrated and competitive industry. The reforms had two main — the removal of legislative and regulatory barriers to the free trade of gas within and across State and Territory boundaries, and the development of a uniform national framework for access to natural gas pipelines. These reforms were brought within the ambit of the NCP process at the April 1995 CoAG meeting.

In November 1997, CoAG agreed on a national framework for third party access to natural gas pipelines. The National Gas Access Code (the Code) will provide a legally enforceable right for third parties, such as suppliers, retailers and users, to negotiate access to pipelines for haulage services on terms and conditions which are fair and reasonable to both access seekers and owners.

The eventual outcome of the third party access regime is expected to be the development of an integrated national gas market and an interconnected pipeline grid which will allow gas to be freely traded across jurisdictions.

SA has passed 'lead' legislation to apply the Code. All jurisdictions, except WA and Tasmania (TAS), have applied the South Australian legislation. WA will enact legislation to apply the Code directly, with essentially identical effect. TAS has agreed to introduce the gas pipelines access law and Code before approval, or competitive tendering for, any natural gas pipeline in that State.

As with electricity, competition in gas retailing is being increased with the progressive lowering of the consumption thresholds which determine the eligibility of customers to choose their gas supplier. In the new competitive gas market, contestable gas customers will be able to contract directly with a gas supplier of their choice, and contract separately with the pipeline owner for the transportation of gas. Further reforms are being pursued co-operatively by governments and industry to increase competition at all levels of the gas industry.

Water

CoAG agreed in February 1994 to a major water reform package to halt the degradation of this natural resource in many parts of Australia. The package includes: pricing reforms based upon consumption, and removal of cross-subsidies; by 1998, the structural separation of service provision from water resource management, urban water tariff reform and new systems of tradeable water entitlements; and by 2001, rural water charges reflecting full cost recovery and achieving, where practicable, positive real rates of return on assets.

In April 1995, governments agreed to bring the water reform agenda within the NCP process. Hence, the second tranche of competition payments to the States and Territories is partly conditional on most of the reforms being implemented. The third tranche is tied to the rural reforms.

Jurisdictions are at different stages in, and taking different approaches to, implementing some of the reforms. NSW and VIC are the furthest advanced. There are many elements still to be put in place and it will be difficult for jurisdictions to meet the timetable. Though difficult and complex, reform is vitally important for the broad community, including environmental sustainability.

Petroleum products

On 20 July 1998, the Government announced new comprehensive reform of the petroleum industry, drawing on the recommendations of a 1996 ACCC report[5]. Whilst these reforms are not a direct result of the NCP, the principles of the package are broadly consistent with the NCP. Previously, the industry was subject to wholesale prices oversight and restrictions on the number of petrol stations that refining companies can operate. The new arrangements will:

- relax the controls on the retail activities of the petrol refining companies;
- give new competitors improved access to the existing major oil refineries and access to the system of 'product swapping' under which the owner of a refinery in one part of Australia swaps product with a refinery in another part of Australia;
- introduce procedures for resolving disputes between firms involved in the distribution of petroleum products, including small independent service station operators and firms involved in petroleum production; and
- provide independent monitoring of retail prices.

A draft set of principles for a new *Oilcode* has been developed in consultation with the petroleum industry, including representatives of the service stations, distributors and independent marketers. The code will be underpinned by the TPA and will be linked to the repeal of the *Petroleum Retail Marketing Sites Act 1980* and the *Petroleum Retail Marketing Franchise Act 1980*. It is intended that the *Oilcode* will provide protection to small business, while maintaining competitive forces in the industry.

Airports

More efficient use of airport infrastructure is a focus of recent reforms to airport pricing and ownership. While the Federal Airports Corporation (FAC) used to operate a uniform network pricing system, there has been a move towards more cost reflective pricing, taking into account location and service specific factors. In 1997-98, the Commonwealth owned airports (except the Sydney basin airports and Essendon) were separated from the network operated by the FAC and then individually privatised. A major review of aeronautical charges was undertaken prior to privatisation and a prices oversight arrangement is in place administered by the ACCC, to ensure that privatised airports do not misuse their market power.

The access provisions of Part IIIA of the TPA were used during 1997 when Australian Cargo Terminal Operators Pty Ltd (ACTO) sought declaration of facilities at Melbourne and Sydney airports to conduct freight handling services. The NCC recommended declaration of most of the facilities nominated by ACTO. The Treasurer agreed with the NCC recommendations and 'declared' the facilities—

5 ACCC, *Inquiry into the Petroleum Products Declaration*, 1996.

'declaration' means that negotiations for access to the facilities can be undertaken with the security of an arbitration process. The FAC has appealed the Treasurer's decision in relation to Sydney Airport. The Australian Competition Tribunal will hear the appeal in December.

Road transport

Following agreement at the 1991 Special Premiers' Conference, the National Road Transport Commission (NRTC) was established to develop nationally consistent regulations and charges for heavy vehicles.

At the November 1997 Ministerial Council on Road Transport, Ministers agreed to an NRTC strategic plan covering the years to 2000-01. The plan maps national road transport reform for the next three years, making reform objectives and performance transparent.

Progress in achieving road reform is one of the preconditions for the States and Territories receiving Competition Payments under the NCP reform package. An issue yet to be determined is the criteria or targets to be used in assessing reform progress.

When fully implemented, the National Road Transport Law will provide a simpler and nationally uniform operating environment for road transport operators, replacing nine current regimes.

Rail

The NCP agreements do not contain specific provisions in relation to rail services although a number of recent reforms to the industry have reflected competition policy thinking. In particular, in a number of jurisdictions control of the track (recognised as a natural monopoly) has been structurally separated from 'above rail' services and some new entrants have begun competing with incumbent 'above rail' operators. The general provisions of the CPA regarding the structural reform of public monopolies and access to infrastructure facilities have been important in this process.

The Commonwealth Government has sold the businesses (other than interstate track) of the Australian National Railways Commission and has announced its intention to sell the Commonwealth's interest in the National Rail Corporation.

Through agreement between the Commonwealth and the States, the Australian Rail Track Corporation (ARTC) commenced operations on 1 July 1998, taking over management of the Commonwealth and Victorian interstate track, and having the task of negotiating access arrangements to track in NSW and WA. The ARTC is a 'one-stop shop' for interstate operators to negotiate access to the national track system.

In 1996, the NSW Government disaggregated its vertically integrated rail monopoly, the State Rail Authority. A number of smaller businesses were established, including Rail Access Corporation (RAC) which now manages the NSW rail track network. RAC has negotiated access agreements with Government-owned and private operators. The Victorian Government has also structurally separated its vertically integrated rail monopoly. The Victorian Rail Track Corporation was established in 1997 to own and operate the Victorian rail track network, and several 'above rail' service providers have been disaggregated from the Public Transport Corporation to provide independent dedicated freight and passenger services.

Several States have also introduced either rail specific or general access regimes under which third parties are able to gain access to the rail network.

Ports

Port management in Australia has traditionally been undertaken by State government-owned authorities. Most port authorities have undergone considerable reform. The general pattern of reform has seen the creation of a statutory corporation with a commercial focus, and the separation of the commercial activities from regulatory activities. CN principles have been applied, including the application of income tax equivalent payments and required rates of return or dividend payments. Non-core functions have been divested to the private sector, leaving many port authorities with only a landlord role.

While not all States follow the landlord model, the trend to divest functions has meant that capital city port authorities now provide relatively few direct services to ships. The Victorian Government has privatised several ports and has vertically separated the Port of Melbourne Authority.

Overall, the changes have resulted in increased payments to State Governments, and port authority charges per unit of cargo have fallen by an average 21 per cent for the major ports from 1990-91 to 1996-97.[6]

6 Calculation based on data contained in *Government Trading Enterprises Performance Indicators 1990-91 to 1994-95* and *1992-93 to 1996-97*, Steering Committee on National Performance Monitoring of Government Trading Enterprises, June 1996 and April 1998.

Comments on Specific issues

5(a) Socio-economic consequences of the NCP

NCP aims to improve the well being of the Australian community by subjecting previously sheltered areas of the economy to competition unless its restriction is in the public interest. As previously described, this encourages firms to provide better quality goods and services at lower cost.

While consumers may directly benefit from these changes, many of the welfare gains associated with competition policy come from indirect effects. For example, lower input costs increase competitiveness and assist sustainable employment in downstream industries. Lower prices bring real gains across the economy as households use their extra disposable income to purchase a range of goods and services. Expansion of the economy increases incomes and provides greater taxation revenue which can be directed at social welfare programs or other areas of Government expenditure. Further, by increasing productivity, and the supply capacity of the economy competition reform allows a higher rate of economic growth to be maintained without raising inflationary pressures.

While competition reform offers net benefits to the community, it is also the case that there are costs to some sections of the community. Those who benefit from current restrictions on competition will not wish to see those benefits removed. (However, it is also the case that while some sections of the community may lose from one area of reform, their losses will often be offset to some extent by gains they receive from other reforms, particularly in the case of businesses which gain from lower input costs.)

There is also the issue of adjustment costs. Change, even when it delivers positive effects, often imposes difficulties during the transition from one set of arrangements to another. In the context of competition reform, the impact on employment for individuals is the most significant adjustment issue. A more detailed consideration of the employment effects of competition reform is provided later in this section, as is an examination of associated adjustment issues.

While exposing previously sheltered areas of the economy to competition may involve costs to particular groups, failing to reform maintains inequitable treatment across the economy. With the phasing down of border protection, the traded sector has largely adjusted to the challenges and opportunities of the global marketplace. Extension of the competitive conduct rules to all Australian business (including the unincorporated sector and GBEs) aims to apply the same competitive pressures

across the community. In many cases, competition policy reforms are about removing exemptions granted to particular groups that have worked against the public interest.

Benefits of competition reform

Quantification of the economy-wide net benefits available from the reform process is a difficult exercise. Nonetheless, in 1995 the Industry Commission (IC) undertook a modelling study for the CoAG to estimate the economy-wide effects of implementing Hilmer and related reforms. The IC estimated that in the long run, once all adjustments have taken place, the reforms would result in an annual gain in real GDP of 5.5 per cent, or $23 billion a year (in 1993-94 dollars). Of this, reforms by the Commonwealth were projected to contribute $4 billion while reforms at the State, Territory and local government level were projected to contribute $19 billion. The IC estimated that real wages would increase by 3 per cent and that consumers would gain almost $9 billion a year, equivalent to an additional $1,500 for each household. Employment gains from higher participation rates were estimated to amount to 0.4 per cent or 30,000 extra jobs. (The modelling assumed that the number of unemployed remains fixed.)

The IC also found that the benefits of the reforms would be widely distributed, with very few industries projected to lose from the reforms and the majority of industries quite clearly gaining. Because the reforms are broad ranging, losses from one reform would tend to be offset by gains from other reforms.[7]

In seeking to estimate the overall net gains from these reforms, the IC recognised that it faced a number of constraints, stating: 'Some of the reforms being considered are broad strategies rather than specific policy changes; or may even have the important but intangible effect of locking in gains from changes that have already been introduced. Moreover, some of the big gains from reform are likely to be of the dynamic kind that are difficult to predict, let alone measure.' The IC stated that the best that it could do was to 'provide general indications of the direction and magnitude of the benefits that flow from these reforms.'[8]

There has been some criticism of the IC's modelling and the IC has acknowledged possible shortcomings in the assumptions it used. For instance, the modelling did not allow for productivity improvements in areas such as telecommunications in the absence of reform. Nonetheless, the IC assessed that even after revising the modelling in the light of such criticisms, the estimated gains from competition reform would still be considerable.[9]

7 IC, The Growth and Revenue Implications of Hilmer and Related Reforms, March 1995.
8 Ibid.
9 Productivity Commission, Stocktake of progress in microeconomic reform, June 1996.

Overseas evidence about the benefits of regulatory reform is not out of line with the IC's modelling results for Australia. Box 5.1 discusses some recent OECD research on the long term benefits of regulatory reform in five OECD countries.

Box 5.1: OECD estimates — benefits of regulatory reform

The OECD recently assessed the potential impact of regulatory reform in five heavily regulated sectors (electricity, air and road transport, telecommunications and distribution) on sectoral and economy-wide performance in five OECD countries, namely the United States (US), Japan, Germany, France and the United Kingdom (UK). Some of the main findings are set out below.

Against a background of considerable scope for productivity increases and an assumed reduction in profits, estimated falls in electricity prices range from 5 per cent in the US to 15 per cent in Germany as a result of further regulatory reform. Reflecting labour productivity growth (although partially offset by the impact of price-induced output growth and innovation), employment in the sector is likely to fall, especially in Germany, France and the UK where there is substantial scope for efficiency gains.

US airline prices have fallen by 20 per cent as a result of regulatory reform over the period 1978-93. There was a price-induced 59 per cent increase in output, while sectoral employment rose by 8 per cent. The OECD estimated that, for Japan, Germany and France, the potential impact of airline regulatory reform on prices and output could be substantial, though of a lower order to the experience of the US. There is likely to be some sectoral employment losses in these countries in the short run.

US road freight prices have fallen by 14 per cent as a result of regulatory reform. For the other four countries, regulatory reform of road transport could see prices falling up to 9 per cent. Employment in the sector may fall, as efficiency gains are not likely to be compensated by the small expansion in output.

Falls in telecommunications prices (of between 6 per cent for the United States and 30 per cent for France) could lead to increased output in the industry (of up to 15 per cent). In addition, there could be substantial innovation-induced output gains from new products. On this basis, reforms could increase sectoral employment levels (up to 11 per cent) despite strong productivity increases.

Looking at the long run macroeconomic effects of the regulatory reforms, the OECD found that the level of real GDP increases substantially, ranging from 1 per cent in the US to 5 to 5.5 per cent in Japan, Germany and France. Real wages increase significantly, though by less than the increase in real GDP. Inflation is unaffected in

Continued ...

the long-run, but the aggregate price level is lower by between 6 per cent (UK) and 12 per cent (France). If only part of the productivity gains is absorbed in wage demands, the OECD argued there could be an appreciable reduction in unemployment. Overall, these estimates suggest a potential for significant gains particularly in the more heavily regulated economies of Japan, Germany and France.

Source: OECD, *The Economic Benefits of Regulatory Reform*, OECD Economic Studies, No. 28, 1997/1.

The benefits of the reform process can be illustrated by examining major areas of reform where substantial progress has been made. In other areas, such as those associated with legislation reviews, the process of reform is not as well advanced.

Electricity. Since 1994 in VIC and more recently in NSW, QLD and the ACT, large users of electricity have had the opportunity to choose their supplier. Stage one of the National Electricity Market (NEM) began on 4 May 1997, covering NSW, VIC, the ACT, SA and the Snowy Mountains Hydro Scheme and allows electricity trading between the State pools of NSW and VIC. In its first year of operation, the average wholesale electricity price decreased by 40 per cent,[10] although there is uncertainty as to whether falls of this magnitude will be sustainable. A recent study by Deloitte Touche Tohmatsu found that electricity costs have fallen by about 30 per cent on average for those businesses able to select their own supplier under the NEM.[11] Similar benefits are expected as other segments of the market become contestable. Smaller electricity users are progressively being allowed to join the competitive market. From 1 July 1998, many small and medium businesses in NSW and VIC (those using 160 megawatt hours of electricity per year) gained access. By July 2001, all customers, including residential users, will be free to choose their electricity supplier.

Gas. The National Gas Access Regime has only recently become operational and it is, therefore, too early to make any firm assessment of its impact. However, lower prices have resulted from increased access to gas distribution provided under interim access arrangements established by the States. Large industrial and commercial gas users in NSW will receive reductions of almost 60 per cent between 1995-96 and 1999-00[12], while in WA tariffs will fall by around 20 per cent by 2000 for gas from the Dampier-Bunbury pipeline.[13]

Rail. The rail industry has undergone structural reform involving the breaking up of vertically integrated rail monopolies in some jurisdictions, while the National Access Regime of Part IIIA of the TPA has assisted in increasing access to some State rail lines. Competition on the Melbourne to Perth route since 1995 has seen rail freight rates fall by 40 per cent.[14] The RAC of NSW estimates that due to increased

10 Electricity Supply Association of Australia, Electricity Australia 1998, p 33.
11 Deloitte Touche Tohmatsu, April 1998, Deloitte Electricity Survey.
12 IPART, July 1997, AGL Gas Networks Limited: Access Undertaking (as varied): Determination.
13 Australian Financial Review, 'WA reforms boost for investment', 29 July 1998.
14 Speech by Mr Graeme Samuel, President of the NCC, to the South Australian Farmers Federation, 24 July 1998.

competition, interstate freight rates have decreased by 10 per cent, while export coal haulage rates in the Hunter Valley have fallen by up to 17 per cent.[15]

In addition, some reforms have been undertaken by State governments which, while not part of the NCP, are in line with competition policy principles. For example, RAC has introduced competitive tendering for infrastructure maintenance throughout the State. This has resulted in lower track access charges, as well as providing increased tax revenue and dividends to the NSW Government. Safety and customer service were improved over the relevant period[16].

Water. The reforms agreed by CoAG in 1994 included the introduction of a system of tradable water rights which will encourage water to be employed in its highest value use. Other reforms include the restructuring and commercialisation of water authorities to make them more responsive to the demands of customers, and removal of some cross subsidies between water users. However, the reforms have also resulted in some bulk water users paying more for water.

Significant reforms have also been applied to the supply of water and sewage services to urban customers. Generally the reforms have involved changing the basis for water and sewage charges to reflect the level of consumption and service. Formerly, charges tended to be independent of resource use, being based instead on other determinants such as property valuations. This has resulted in reduced water usage, especially by industrial and commercial businesses. These reductions have enabled the delay of expensive and potentially environmentally damaging dams. For example, the introduction of pay-for-use pricing in the Hunter Valley reduced average water consumption by around 30 per cent which delayed the need for a new dam with a capital cost of over $50 million by at least 10 years.[17]

Telecommunications. Managed competition was introduced into the telecommunications industry in 1991, with the entry of Optus ending Telstra's monopoly. Full and open competition has been allowed since 1 July 1997. Between 1992 and 1997 the real price of telephone services declined by more than 10 per cent, and charges fell by 15 and 32 per cent (representing falls in real terms of 24 and 40 per cent) for national and international long distance calls respectively. Since the opening of the telecommunications market to full competition there have been significant price reductions for many categories of services, particularly for national and international long distance calls. For instance, consumers have realised savings over 1997-98 of up to 47 per cent for STD calls and up to 71 per cent for calls to some international destinations.[18]

The telecommunications regulatory environment includes safeguards to ensure that productivity improvements are passed on to consumers and shared between urban and rural areas. For example, local call price parity arrangements ensure that

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15 Speech by Ms Judi Stack, CEO of the RAC, to the Rail Australia Conference, 20 July 1998.
16 Ibid.
17 IC, *Water Resources and Water Waste Disposal*, Report No. 26, AGPS, Canberra, 1992, p 158.
18 Treasury estimates based on the cost of a three minute call during peak tariff periods.

Telstra's rural customers face the same local call prices as the average Telstra urban customer. In addition, Telstra, as the currently designated national universal service provider, is obliged to provide standard telephone services (including equipment and line rental and provision of payphones) to all parts of Australia. Telstra is funded for losses incurred in providing these services from a levy paid by telecommunications carriers.

Improvements in the range and quality of services available have also been significant. For instance, the private use of facsimile and other data services such as accessing the internet were uncommon only a few years ago; but are now widely available. While technical feasibility impacts on the provision of such services to more sparsely populated areas, there is evidence that carriers are seeking to address these differences in service levels. For instance, Telstra, through its progressive network upgrades was expected to achieve 85 per cent parity between the services available to country customers compared to those available to metropolitan customers by the end of 1997[19].

OECD research on the link between competition in telecommunications services and the uptake of the Internet provides further illustration of the benefits of competitive — see Box 5.2.

Box 5.2: Access to the Internet and the benefits of competition

Recent OECD research shows competition among telecommunications service providers is bringing down the cost of access to the Internet and expanding the number of people who use it. The penetration of the Internet was found to be five times higher in competitive than monopoly markets mainly because of much lower prices. For example, in 1995 the prices of Internet Access Providers for dial-up services were on average nearly three times more expensive in countries with monopolies than those with competitive markets.

(Source: OECD, *The OECD Observer*, No. 201, August/September 1996).

Australia, by moving to a competitive telecommunications environment, is therefore well placed to participate in the benefits of the communications revolution. This is evidenced by recent initiatives under the pro-competitive telecommunications regulatory regime to prohibit anti-competitive practices in the industry and ensure access to telecommunications infrastructure. The communications revolution is producing major changes in the way businesses and governments go about their business, communicate and exchange information, market themselves and their products, deliver products and services and interact with the public. Australia already has one of the highest Internet penetration ratios in the world. It is now estimated that there are over 1,000 service providers operating in Australia, providing greater choice for consumers and driving the evolution of new and innovative products. Further downward pressures on the price of dial-up services

19 Department of Communications and the Arts, Standard Telephone Service in Rural and Remote Areas, 1998.

could be expected to arise from increased competition in the market for local calls and the development of alternative technologies for accessing Internet content.

As stated above, many of the gains from reform are due to the indirect benefit of lower costs which greater competition delivers to downstream service users. For example, lower electricity costs can stimulate business activity and employment because electricity is an important input. NSW Treasury estimates that in the long run electricity reforms will add almost $1 billion per annum to real Gross State Product and generate in excess of 14,000 additional jobs across NSW.[20]

In addition to the economic gains provided by competition reform, it can also deliver significant environmental benefits. For example, by removing barriers to entry and promoting competition, energy market reform improves incentives to increase the efficiency of conventional technologies, such as coal fired power stations, as well as providing greater scope for the emergence of new energy technologies such as the use of renewables and co-generation. Linking the electricity suppliers to the national grid also has environmental spin-offs as better capacity utilisation across the interconnected market allows the operation of fewer generators to supply a given level of demand, thereby reducing the impact of electricity generation on the environment. In addition, efficiency standards for fossil fuel electricity generation are to be implemented by 2000, delivering both economic and greenhouse benefits.

Similarly, in the case of natural gas, the NCP reform process will help to provide environmental benefits through the encouragement of an integrated national gas market and interconnected pipeline grid. Fossil fuel resources are still expected to provide the bulk of Australia's energy supplies into the foreseeable future. However, lower prices for natural gas through the acceleration of gas market reform encourages more co-generation using natural gas which, as a less carbon intensive fuel, reduces greenhouse gas emissions.

Adjustment costs

In implementing NCP, governments recognised that there would be adjustment costs. However, under NCP, governments have to decide, based on the available evidence, whether long term benefits from reform accruing to the broader community outweigh any transitional costs incurred by particular groups. The challenge is to manage any social costs in the short term to facilitate appropriate restructuring.

When firms come under pressure to increase productivity, adjustments to production processes, and their location, may need to be made with associated costs. Shielding firms from competition to avoid these adjustments imposes significant costs on the community and is an inefficient and indirect way of assisting those who may be

20 NSW Treasury, 'Microeconomic Reform Progress', http://www.treasury.nsw.gov.au/research/trp97_1/micro.htm.

adversely affected. Assistance to those who are adversely affected is best provided directly through assistance aimed at facilitating adjustment and spreading the adjustment costs across the community.

The automotive industry illustrates the difficulty in trying to insulate an industry from change. Since the peak of automotive employment in 1973, the effective rate of assistance was substantially increased, reaching 250 per cent in the mid 1980s. Despite this high level of assistance, employment in the industry continued to decline, while imposing significant costs on consumers and the national economy.

In any case, it should be noted that the introduction of competition into an industry may yield benefits that largely offset any associated adjustment costs. Jobs may be created as new competitors enter an industry, and existing operators may increase output and employment as price reductions stimulate greater demand. These new jobs may partially, or more than, offset job losses in the former monopoly supplier. For example, while Telstra has reduced its labour force, Optus and Vodaphone have created new jobs, as have the many service providers that have emerged in the telecommunications industry. Similarly, while AP has reduced its staff over recent years, there has been employment growth among private couriers and mail handlers.

As well as competition reforms, overall employment in the communication sector (postal, courier and telecommunication services) has been affected by a range of factors including technological change and strong industry growth. Fluctuations in employment reflect the dynamic nature of the industry. As stated above, while there have been job losses in Telstra and AP, there have been employment gains in other areas of the sector. As a result, total employment at June 1998 was on par with numbers prevailing in the late 1980s, at around 146,000.

The electricity supply industry, which has experienced a substantial decline in employment during the past decade, might be considered as an example of an industry that has not seen new job creation following competition reforms. However, examination of the statistics does not necessarily bear this out. From 1987 to 1995 employment in the electricity supply industry declined from over 75,000 to approximately 42,000. Approximately 36,000 people were employed in 1997[21]. It is apparent from these figures that employment in the industry was trending downward prior to the introduction of the NCP, due to factors including efforts by State governments to address over-staffing.

Adjustment assistance

In pursuing the benefits of NCP, governments need to give serious and informed consideration to appropriate adjustment mechanisms. In particular, some groups or regions may disproportionately bear the costs of the reform process.

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21 Electricity Supply Association of Australia, *Electricity Australia 1992*, p 61; and *Electricity Australia 1998*, p35.

While these issues need to be given due attention, there is always a risk that opportunities to improve the welfare of the community will be lost or devalued, if governments become influenced by sectional interests highlighting the costs of adjustment to themselves.

There are legitimate questions about the speed and magnitude of reform, and the need for, and best means of delivering, adjustment assistance to particular groups or regions. The transition to a more competitive environment can be eased by gradual implementation. Announcing future arrangements prior to implementation provides certainty for industry and time to adjust to changing conditions. Governments can also provide assistance to workers or regions particularly hard hit.

Implementing a range of reforms in tandem spreads the costs and benefits across the economy. While firms or households may be adversely affected by one set of reforms, they may simultaneously reap the benefits of others. For example, while border protection of most manufacturing has been virtually eliminated, the manufacturing sector has benefited from reform in areas such as telecommunications and electricity.

While the speed of implementation needs to be flexible, delaying reform is not costless. It perpetuates existing distortions and inefficiencies, such as those arising from barriers to entry and monopoly pricing, and postpones the potential flow of benefits to the community in terms of higher incomes and employment. Maintaining anti-competitive arrangements often allows business to sustain higher prices and profits at the expense of consumers. In many cases distributional equity will be enhanced by accelerating reform and allowing ordinary consumers access to alternative suppliers.

Effective competition reform will generate greater revenue to the Commonwealth through the impetus provided to business and consumption (via lower costs to consumers). Under the NCP package, the States and Territories that undertake NCP reforms receive Competition Payments to share in this additional revenue (as discussed in Section Three). If governments so wished, some of these funds could be directed towards funding suitable adjustment schemes.

CSOs

CSOs are services provided on a non-commercial basis to fulfil identified social purposes. The Steering Committee on National Performance Monitoring of Government Trading Enterprises defines CSOs as follows: ‘A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the

public or private sectors to generally undertake, or which it would only do commercially at higher prices'. [22]

Concern has been expressed that the introduction of competition will threaten the continued delivery of CSOs. There is, however, no inconsistency between competition policy and CSOs. Prior to introducing competition into a market traditionally supplied by a public monopoly, the CPA requires governments to review the merits of any CSOs undertaken by the public monopoly and the best means of funding and delivering any mandated CSOs.[23] Once governments assess which CSOs to provide, the main issue for competition reform is how they should be funded.

The traditional means of funding CSOs has been through internal cross subsidies by an incumbent monopolist. However, it is not possible to maintain internal cross-subsidies in a competitive environment as these cross-subsidies rely on barriers preventing the entry of potential competitors.

Cross-subsidisation involves charging some categories of consumers at a higher rate in order to subsidise others. In the past, there has been a tendency for the business sector to subsidise household consumers in the provision of public operated utility services, while urban residents have tended to subsidise rural residents. However, charging some consumers at a higher rate to subsidise others becomes untenable where there is access to alternative suppliers who do not contribute to funding the CSO and whose prices more closely reflect the cost of providing the service.

Alternatives to internal cross-subsidisation are available as means of funding CSOs. Notably, they can be funded directly from the budget or through a levy on all suppliers in the industry. Both have the advantage that restrictions on competition can be removed while maintaining funding to cover the cost of CSOs. While each jurisdiction is free to decide how to fund their CSOs, most governments have stated in-principle support for direct funding from consolidated revenue. An industry levy is in place in the telecommunications industry, where all industry participants are required to contribute to the cost of providing the CSOs according to their market share.

Direct budget funding increases the transparency of the subsidy and clearly separates CSOs from commercial activities. In the past non-commercial activities have been poorly defined, with the uncertainty surrounding a GBE's social role detracting from efforts to improve performance. Direct funding of CSOs provides the opportunity to better target and monitor the effectiveness of program delivery. Subjecting CSOs to the budget process also allows them to be assessed against alternative welfare or other programs, thus providing greater accountability and ensuring they reflect governments' social priorities.

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22 SCNPMGTE (Steering Committee on National Performance Monitoring of Government Trading Enterprises), *CSOs: Some Definitional, Costing and Funding Issues*, IC, Belconnen, 1994.

23 CPA, subclause 4.(3)(f).

An industry levy based on market share, while still involving an element of cross-subsidisation, also has the advantage that the ability to fund the CSOs is not affected by changes in market competition. That is, if a firm's market share falls, other firms whose market shares increase as a result will contribute more to the cost of CSOs. Apart from the need to continue cross-subsidies, the main disadvantage of an industry levy is that it is likely to result in higher administration and compliance costs compared to alternative means of funding.

The Professions

There has been some concern that NCP legislative reviews will lead to the erosion of professional standards in areas with important social implications, such as medicine and the law. Scheduled reviews include legislation covering lawyers, dentists, optometrists, pharmacists, veterinary surgeons and architects. Most of the reviews have not yet commenced. Without seeking to pre-empt their findings, it is useful to clarify the objectives of the review process as it relates to the professions.

The application of competition policy to the professions, as in other areas of NCP, is not about introducing unfettered competition or the erosion of professional standards. It is concerned with examining the existing legislative restrictions, regulations and codes governing these areas and determining whether they serve the public interest or simply exist for the benefit of the profession concerned.

In many cases, poor information and the inability of consumers to accurately assess the capability of practitioners suggest a need to regulate standards of accreditation and the use of professional titles. Consumers are then able to purchase services with some confidence in the practitioner's ability and professional standing.

However, excessively high accreditation standards may serve to unnecessarily prevent suitably qualified people from providing a competent service. For example, in most States conveyancing services, once the preserve of lawyers, are now also performed, at significantly less cost, by non-lawyers, with no appreciable drop in standards. Advertising restrictions may unduly hamper the flow of information to consumers concerning prices and the range of services on offer. Similarly, prescribed fee scales may restrict price competition to the detriment of consumers.

The legislation reviews covering the professions will assess the costs and benefits of these and other restrictions. Where the restriction on competition is not justified on public benefit grounds, there may be alternative mechanisms such as voluntary arrangements or enhancing information flows which safeguard the public interest without unduly hampering competition.

5(b) Relative effect and variation in impact of the NCP on urban and rural regional communities

NCP involves a comprehensive set of reforms directly affecting many sectors of the economy and indirectly impacting on many more. Similarly, the reforms impact broadly on rural, regional and urban communities. This is not only so for the NCP package as a whole but also for many individual reforms. For some reforms, such as in telecommunications and energy, this is because those industries provide services in the form of comprehensive geographical networks. In other cases, while reforms may involve an industry focused on, say, rural areas, there can be important flow-on effects to regional centres and/or urban industries. For example, agricultural products grown in rural areas may be further processed in urban centres. Or urban-based infrastructure, such as ports or airports, may be important in the distribution of rural products.

Nonetheless, while the impact of competition policy is broad, it is also the case that it is likely to fall unevenly across different communities. This is firstly because some industries are much more significant in some parts of Australia than others. Agriculture and mining are centred in rural areas, while manufacturing is concentrated in urban areas and service industries are important in both urban and regional centres.

Secondly, market structures vary considerably between rural, regional and urban areas. For example, in urban areas there may be hundreds, or even thousands, of professionals practising in a given field (such as medicine or accounting) and competing for business, while in small towns there will often be only a few.

The pace of implementation has also varied between different areas of reform. Where a particular reform concerns an industry concentrated in rural areas or in urban areas, then the timing of its implementation will influence how competition policy impacts on those areas. For instance, the restructuring of State and Territory monopolies has been substantially progressed and the competition provisions of trade practices legislation have been extended to the professions and government owned businesses; these initiatives affect mainly the utilities and professions concentrated in urban areas and larger regional centres. On the other hand, there are further legislative reviews covering various primary industries scheduled to be undertaken, and the further development of access regimes for a number of services important to rural areas (such as rail) is still required.

Although the experiences of urban and non-urban areas with the NCP reforms will not be the same, this does not imply that one section of the community gains at the expense of the other. As already outlined in this paper, there is good reason to believe that the reforms will be of broad benefit to the community. Lower input costs for services such as telecommunications and transportation benefit individuals and industries in both urban and non-urban areas.

It is difficult to assess the relative impact of the NCP on rural and regional communities compared with cities. However, there are reasons for supposing that net benefits may be larger in the urban areas because:

- adjustment costs are likely to be relatively greater in rural and regional areas; and
- some of the significant benefits of competition policy may accrue more to urban areas.

The history of regulation in some rural industries and the high exposure to a small number of industries in most country areas is likely to amplify adjustment costs. Also adding to adjustment costs is the tendency for labour in rural and regional areas to be less mobile than in cities because changes in employment are more likely to entail a shift in place of residence, or if the change is made, higher dislocation costs are involved.

On the benefits side, the different industry profiles between urban and rural areas, and the associated differences in the importance of particular inputs, could provide relatively greater benefits to urban areas. For instance, electricity and gas would generally be more important inputs to manufacturing industries than to rural industries and, consequently, price falls for those products could be expected to be of relatively greater benefit to urban areas. Likewise, falls in telecommunications prices may have benefited urban industries more, given the importance of communication services to some urban-based service industries (among others). The relative incidence of benefits between cities and country areas is a complicated one and almost certainly not one — in contrast to the previous examples, more efficient rail services is of particular importance to grain — but in total may flow more heavily towards urban areas.

Although net benefits to rural and regional areas may be less than those accruing to urban areas, this is not an argument against the reforms proceeding, nor does it imply that rural and regional areas are subsidising urban areas. However, if there is an imbalance in the distribution of benefits from the reforms, then governments may wish to increase their focus on re-distributive elements to ensure a more even spread of benefits. CSOs and labour market adjustment measures would be relevant to achieving such goals. Provided that there is a net benefit to the community as a whole, the reforms are worth pursuing; nonetheless, the distribution of those benefits is an important issue.

To date there has not been any real focus on the costs and benefits of NCP reforms in rural and regional Australia and insufficient data to make an appraisal of these costs and benefits. In this regard, the current Productivity Commission inquiry into the *Impact of Competition Policy Reforms in Rural and Regional Australia* should provide a more comprehensive picture of the impact of these reforms on non-urban areas. The Commission is due to report in September 1999.

Context in which the NCP has been implemented

As discussed in Section Two, extensive sectoral and other reform was already under way when the NCP reform package was initiated. There have also been many other influences on the level of activity, profits and employment, especially in rural areas. In many cases these influences have been, and will be, as important or more important than NCP reforms. Major influences include:

- trade liberalisation;
- changes in commodity prices;
- changes in technology; and
- reductions in rural populations.

Trade liberalisation. Tariff reductions and the removal of other Australian trade barriers (such as quotas) in the 1970s, 1980s and 1990s have impacted on firms in both rural and urban industries. Many have gained from the lower prices and expanded trade associated with lower protection, but for others the reforms have entailed significant adjustment costs.

Commodity prices. Movements in commodity prices can have a profound impact on the fortunes of industries concentrated in rural and regional areas. Between 1988 and the beginning of the Asian currency crisis in 1998, the Australian Bureau of Agricultural and Resource Economics' overall index of prices[24] received by farmers has reached a high in 1995-96 which is 20 per cent above its 1992-93 low. Individual commodities have been considerably more volatile than these composite indices.

The Dresdner Commodity Price Index[25], which includes changes in prices since the currency crisis, shows that a fall of almost 14 per cent in agricultural commodity prices occurred between September 1997 and September 1998.

Technology changes. An example of the effect of technology is the reduction in the number of bank branches in towns as well as in urban areas. As alternatives to branch-based transactions, such as EFTPOS and telephone banking, have been developed and increasingly taken up by customers, banks have been inclined to reduce branches. However, bank branches closing in rural areas can be of much greater community significance than branches closing in urban areas because the costs of travelling to the next nearest branch can be greater in rural areas than in urban areas.

Population. While the population of some regional centres has grown, numbers in many farming communities and small rural towns have been on a downward trend[26]. In a survey of population shifts between 1986 and 1996, the Australian Bureau of

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24 ABARE, *Australian Commodities*, September Quarter 1998.

25 National Farmers Federation, *International Commodity Price Review*, September 1998 – in Australian Dollar terms.

26 Australian Bureau of Statistics, *Australian Demographic Trends*, 3102.0, 1997. These statistics indicate population falls in a number of country areas between 1986 and 1991.

Statistics found that of the 578 country towns in 1986 with populations between 1,000 and 20,000, approximately 58 had lost 10 per cent or more of their population by 1996. Population declines were most prevalent in wheat growing and sheep grazing areas and among mining towns. (On the other hand, approximately 270 towns had experienced increases in population of at least 10 per cent. However, most of these towns were located near capital cities and regional centres.)[27]

Application of public benefit test to rural industries

The difficulty in assessing the expected impact of the NCP reforms on rural and regional (and urban) Australia is compounded by the fact that public benefit considerations may require that existing arrangements be retained, or the pace of reforms slowed. While it is entirely appropriate that public benefit factors are fully considered when implementing reforms, it can make prediction of the likely impact of the NCP reforms more difficult in some cases.

The public benefit test is discussed more broadly in Section 5(c), but a brief consideration is given here in the context of its application to rural / regional issues.

Public benefit considerations are broad enough to include many factors relevant to rural industries. For example, the guidelines and decisions published by the NCC, ACCC and Australian Competition Tribunal recognise that public benefit may exist when rural industry participants enter into joint arrangements to:

- enable the funding of R&D in industries;
- reduce the cost of negotiating large numbers of individual supply contracts;
- ensure quality is maintained; and
- reduce the need for many individual competitors to collect and process information.

The NCC, ACCC and Australian Competition Tribunal also recognise that public benefit can arise in a rural or regional context when proposed arrangements:

- are temporary and part of a smooth transition process from a regulated to deregulated market;
- promote employment in regional areas;
- smooth short run market fluctuations that might otherwise result in increased information costs, the diversion of effort into speculation or poor landcare practices; and
- increase export earnings.

27 Australian Bureau of Statistics, *Australian Social Trends*, 4102.0, 1998.

Public consultation on legislative reviews

An important mechanism for canvassing broader public interest considerations is the public consultation processes which are part of many of the scheduled reviews of legislation restricting competition. This public consultation allows stakeholders to present their views to the body undertaking the review and, in some cases, has extended to participation in the review committee itself. The consultation process is intended to provide an opportunity for relevant parties to contribute information and analysis on the costs and benefits of the legislation under review.

The nature and extent of public consultation varies according to the form of the review and the importance of the legislation to relevant sections of the community, but close public consultation has characterised key legislative reviews concerning the rural sector. In 1995, the QLD and Commonwealth Governments established a Sugar Industry Review Working Party to review the QLD sugar industry's regulatory arrangements and the tariff on sugar. The Working Party included representatives of canegrowers and sugar millers, as well as a representative of sugar users. Likewise, the 1996-97 review of the Rural Adjustment Scheme included representation of rural interests on the committee. Both reviews recommended significant changes which were accepted by government.

Statutory Marketing Authorities (SMAs)

In the past, competition in many primary industries has been regulated by statutory marketing arrangements established under Commonwealth or State government legislation. Under these arrangements, SMAs have been responsible for marketing and sales of many major rural products, including poultry, wool, wheat, meat, rice, barley, eggs, tobacco, sugar and milk. The SMAs were generally exempt from the competition provisions of the TPA.

In the 1980s many SMAs were significantly reformed. The NCP built on these reforms by subjecting the authorities to the competition provisions of the TPA. It also set a timetable for the review of legislation governing SMAs and the industries in which they are involved, to either justify or remove any restrictions on competition.

In many cases, SMAs have collected levies from producers and many have operated 'single desk' purchasing and selling arrangements in Australian and/or export markets. The NCP does not prevent common levies or 'single desks' but it does require an assessment of whether the public benefits from these policies justify any restrictions on competition. If a net public benefit is judged to exist, these industry-wide arrangements may be maintained by an ACCC authorisation or through an industry-specific exemption under Subsection 51(1) of the TPA.

In its authorisation of primary produce arrangements restricting competition, the ACCC has noted a number of public benefits associated with such arrangements.

One general observation about such authorisations is that net public benefits are more likely to be judged to exist with regard to single export desks (such as the one retained for the sugar industry) than arrangements that reduce competition to supply Australian customers. The South Australian chicken industry is an example of an ACCC authorisation for arrangements restricting competition in a primary industry; this is discussed in Box 5.4.

Box 5.3: Case study — South Australian Chicken Industry

Before the introduction of the NCP, the *Poultry Meat Industry Act 1969* (SA) governed competition in the South Australian chicken industry. The legislation established a Poultry Meat Industry Committee that negotiated chicken prices and other terms and conditions on a collective basis. It also had the power to decide whether new growers should be permitted to enter the industry.

In accordance with the NCP, the South Australian Government proposed to repeal the *Poultry Meat Industry Act* subject to the outcome of industry initiated alternative arrangements. Inghams Enterprises Pty Ltd and its chicken growers applied to the ACCC for authorisation of an arrangement for the collective negotiation of prices, terms and conditions for the chicken market.

The proposed arrangements are for collective agreements to be negotiated every six months between chicken growers through their elected representatives and Inghams. There would also be a dispute resolution procedure. However, individual growers could negotiate separately with Inghams if they prefer.

The ACCC granted authorisation for the arrangements because it recognised that net benefits were likely to result from:

- a gradual de-regulation process;
- more even bargaining power between the large number of small growers and the strong, large buyer (countervailing power); and
- reducing the costs of a large number of separately negotiated supply agreements.

Source: Australian Trade Practice Reporter, 1997.

Many of the statutory marketing arrangements are still in place and yet to be reviewed. Therefore, it is too soon to assess how large the benefits and costs will be and who may gain or lose from any changes to these arrangements. However, a couple of general observations can be made. If arrangements restricting competition are removed, it could be expected that domestic prices would fall, thereby benefiting Australian consumers but disadvantaging growers. Some growers, however, may benefit from less restrictive marketing arrangements. For example, there may be more scope for individuals to expand or diversify production, to develop innovative or high quality niche products, or to obtain advantageous supply deals outside the current marketing regime.

5(c) Clarification of the definition of public interest and its role in the National Competition process

When introducing the NCP reform package, the participating Commonwealth, State and Territory Governments recognised the importance of taking the socio-economic consequences of the reforms into account, rather than focussing solely on potential efficiency gains from increased competition. To reflect this, the package encompasses the notion that reforms must benefit the public at large or, to put it another way, be in the 'public interest'. This concept of public benefit or interest is equally relevant to those aspects of competition policy (notably the TPA) in place prior to the NCP reform package.

Public Interest under the NCP Reforms

Public interest considerations are an integral aspect of the NCP reform package. Subclause 1(3) of the CPA states:

> *'Without limiting the matters that may be taken into account, where this agreement calls for:*
>
> *(a) the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or*
>
> *(b) the merits or appropriateness of a particular policy or course of action to be determined; or*
>
> *(c) an assessment of the most effective means of achieving a policy objective;*
>
> *the following matters shall, where relevant, be taken into account:*
>
> *(d) government legislation and policies relating to ecologically sustainable development;*
>
> *(e) social welfare and equity considerations, including CSOs;*
>
> *(f) government legislation and policies relating to matters such as OH&S, IR and access and equity;*
>
> *(g) economic and regional development, including employment and investment growth;*
>
> *(h) the interests of consumers generally or of a class of consumers;*
>
> *(i) the competitiveness of Australian businesses; and*
>
> *(j) the efficient allocation of resources.'*

Although the term 'public benefit' or 'public interest' is not explicitly mentioned in subclause 1(3), the factors listed clearly encompass public interest/benefit considerations. As the opening words of the subclause suggest, the factors are not intended to be an exhaustive list, and other matters may be taken into account. Use

of the words *'where relevant'* indicates that not all the factors are necessarily required to be considered in all cases. Further, the listing of the factors does not imply any order of significance, and the emphasis given to each factor may vary as the case requires.

The factors set out in subclause 1(3) of the CPA underpin the principles and processes for future reform set out in the agreement, particularly those relating to legislation review and CN. Decisions to proceed with reforms in these areas require an assessment of whether the benefits to the community outweigh the costs. If this can not be shown, the reform should not proceed.

The process of considering the public interest will generally fall to the jurisdiction implementing the particular reform. However, the CPA envisages that the NCC can assist jurisdictions in this regard. For example, under the legislation review principles, a jurisdiction may seek to have the NCC conduct a national review, where it is considered review of the legislation in question has national implications.

Even where the NCC does not itself conduct a review, it nevertheless has an interest in making sure public interest factors are given adequate consideration by participating jurisdictions when implementing the NCP reforms. In particular, it is important that the public interest test be applied rigorously and transparently, so as not to undermine public confidence in the reform process. This sentiment has been expressed by the HoRSC on Financial Institutions and Public Administration which stated:

> *'The major principles jurisdictions should follow are transparency, objectivity, analytical rigour and achieving a balance of input from relevant and interested parties. These principles are also reflected in the NCC's expectations.'*[28]

The Standing Committee also recognised that, while jurisdictions generally retain the right to determine how the competition reforms are implemented, inconsistency in the application of the public interest test can impose costs and reduce certainty. It recommended that the jurisdictions develop a common set of basic principles to apply the public interest test.[29] In its response to the report, the Commonwealth indicated it would work with the States and Territories to this end.

Ultimately, if the NCC is not satisfied that public interest considerations have been given appropriate consideration by a jurisdiction, this may be a matter to raise in its annual report on the progress of the participating jurisdictions' implementation of the NCP reforms. In the case of the States and Territories, this assessment is relevant to the receipt of Competition Payments.

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28 House of Representatives Standing Committee on Financial Institutions and Public Administration, *Cultivating Competition*, June 1997, p18.

29 Ibid. pp20-21.

Examples of public interest considerations under the NCP reforms

In reviews of primary product marketing arrangements, the NCC has accepted that the restrictions on competition inherent in the single desk export selling arrangements for rice and sugar may nevertheless be in the public interest, for example, in the attainment of export price premiums.

The review of the *Water Resources Act* in SA found that while the water allocation and resource management provisions of the legislation restricted competition, they still generated net benefits through reducing the risk of environmental degradation and disputes over water usage.

In its review of the *Australian Postal Corporation Act* the NCC recommended that AP be subject to competition in the provision of business mail services. However, the NCC recommended that AP continue to be the monopoly provider of household mail, as this was necessary to ensure the continuance of the uniform rate of postage for such mail — an important social objective for postal services.

In relation to access to essential facilities, the NCC recommended against the declaration of the Brisbane to Cairns rail line. The Premier of QLD decided not to declare the rail line, albeit for reasons different to the NCC, as he considered this would not result in a net public benefit. In particular, the Premier was not satisfied that access to the rail line would promote competition in another market, which is one of the criteria for declaration.

Public Interest under the TPA

The concept of public interest or benefit is also present in the TPA. In particular, Part VII of the TPA provides a mechanism by which the ACCC may 'authorise' conduct which might otherwise contravene the competitive conduct rules in Part IV of the Act, on the basis that the public benefits resulting from the conduct outweigh the anti-competitive detriments. Similarly, public benefit is also relevant to the notification procedure in Part VII of the TPA.

The meaning of public benefit in terms of authorisation (or notification) of conduct under the TPA has been extensively considered by the ACCC, the Australian Competition Tribunal (and their forerunners, the Trade Practices Commission and Trade Practices Tribunal), and the courts. It has been given a broad interpretation. A list of items that have been recognised as public benefits are set out in the ACCC publication *Guide to Authorisations and Notifications* (November 1995). The ACCC's *Rural Guideline and the Trade Practices Act* publication (December 1997) lists public benefit factors with a particular rural focus.

Public interest considerations are also relevant under the third party access regime (discussed in Section Three) inserted into the TPA as part of the NCP reforms. For

example, the NCC must determine that access (or increased access) to a service the subject of a declaration application would not be contrary to the public interest, before recommending declaration to the relevant Minister. The Minister must likewise consider this criteria before making a final decision on declaration. Similarly, the ACCC takes the public interest (including the public interest in having competitive markets) into account when deciding whether to accept a voluntary undertaking relating to access.

Useful case studies of recent access determinations, including application of the public interest 'test' by the NCC and ACCC, are set out in Appendix C of the IC Staff Working Paper titled *Public Interest Tests and Access to Essential Facilities*.[30]

Examples of 'non-economic' public interest factors considered under the TPA

The following are examples of factors, not exclusively or primarily economic in nature, which have been considered by the ACCC (and the former Trade Practices Commission) as providing public benefits in authorisation determinations:

The creation of facilities in remote areas. In determining an application for authorisation of a covenant between joint venture parties relating to the development of various commercial facilities in a new township, which contained a provision restricting availability of land for development purposes for other parties, the TPC considered that the covenant provided a public benefit in that it would ensure a standard of development of various facilities (motel, supermarket and tavern) that would not otherwise be likely to be available at a relatively early stage of that township's development.[31]

Promoting product quality. In determining an application for authorisation of a joint venture agreement for the production of insulin, the TPC considered it a public benefit that the agreement would allow a domestic producer of insulin to improve the quality of the insulin it produced due to access to improved technology of its overseas joint venture partner.[32]

Encouragement and preservation of small businesses. In determining an application for authorisation for the circulation of suggested price lists by a small business association to its members, the TPC considered that the lists did provide some assistance to the businesses and thus produced a public benefit, in that they provided a guide to prices and pricing policy for the business owners who generally worked

30 Jeff Hole, Andrew Bradley and Patricia Corrie, *Public Interest Tests and Access to Essential Facilities*, IC Staff Working Paper, Melbourne, March 1998.
31 *Birkenfield Pty Ltd* (1987) ATPR (Com) 50-052.
32 *Commonwealth Serum Laboratories Commission* (1985) ATPR (Com) 50-088.

all day every day, and as such could save them time and contribute to their viability and efficiency.[33]

Facilitation of move from regulated to deregulated market. In considering an application for authorisation of a franchise and marketing agreement between an industry body and producers, the TPC considered that public benefit would flow from the arrangements as they would facilitate the move from a highly regulated environment to a deregulated one, and would help to avoid a dislocation in the functioning of a market that might be caused by too swift a move from regulation to deregulation.[34]

Environmental factors and public safety. In determining an application for the authorisation of a proposed joint venture for the manufacture of sodium cyanide and associated exclusive marketing arrangements, the ACCC considered that public benefit would result from the techniques and technology that would be brought to the joint venture, which had the potential to improve the efficiency of existing operations and thereby provide substantial environmental benefits, particularly in the net decline in nitrous oxides and greenhouse gases.[35]

In determining an application for authorisation of agreements which sought to limit imports of hydrochlorofluorocarbon gases (HCFCs) and voluntarily ban the import or manufacture of disposable containers of HCFCs and hydroflurocarbon gases (HFCs), the ACCC accepted that the public would benefit from the arrangements in that they would limit imports of ozone depleting substances; reduce the amount of solid waste inherent in large disposable packaging; and remove a potentially dangerous form of packaging from the marketplace.[36]

In determining an application for authorisation of a proposal to implement an industrial waste reduction scheme and for manufacturers of agricultural and veterinary chemicals to charge a levy to finance the scheme, the ACCC considered that public benefits would flow from, among other things, improvement of the environment by providing for appropriate disposal of unwanted empty containers of agricultural and veterinary chemicals.[37]

Public Interest and Exceptions from the TPA

The factors in subclause 1(3) of the CPA are also relevant when a jurisdiction is considering enacting legislation that excepts conduct from the Competition Laws, using the process set out in section 51 of the TPA (described in Section Three). The CCA requires States and Territories that use the exception process to notify the ACCC within 30 days of the legislation being enacted. The Commonwealth Minister has the discretion to override such legislation by making regulations under the TPA.

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33 *Retail Confectionery and Mixed Business Association* (1977-78) ATPR (Com) p16,989.
34 Victorian Egg Industry Co-operative Limited (1995) ATPR (Com) 50-198.
35 DuPont (Australia) Limited and Others (1996) ATPR (Com) 50-231.
36 Association of Flurocarbon Consumers and Manufacturers Inc. Authorisation No. A90658, 26 August 1998.
37 Avcare Limited Authorisation No. A30194, 2 September 1998.

However, if the Commonwealth Minister tables the overriding regulations in the Commonwealth Parliament more than four months after the relevant State or Territory has notified the ACCC, at the time of tabling the regulations the Minister must also table a report from the NCC considering:

- whether the benefits to the community from the (State or Territory) legislation, including the benefits from transitional arrangements, outweigh the costs;
- whether the objectives achieved by restricting competition by means of the legislation can only be achieved by restricting competition; and
- whether the Commonwealth should make regulations overriding the legislation.

While it is not stated explicitly in the CCA, the NCC takes the view that in preparing this report it should apply the criteria in subclause 1(3) of the CPA in assessing the costs and benefits to the community. First, because the factors in subclause 1(3) are likely to be those that participating States and Territories take into account in assessing the benefits and costs to the community in the legislative review process (including where new legislation restricting competition is proposed) and secondly, where the NCC is given the task of undertaking a review of legislation with national implications, it will take these factors into account.

As is evident from the factors relevant to assessing the public interest under the NCP reform package (and under the provisions of the TPA), it is not a narrow concept focussing solely on competition. Rather, it is a broad and flexible concept, encompassing a range of social issues. The inclusion of the requirements in subclause 1(3) of the CPA reflects the desire of governments to make clear that competition policy is not about maximising competition as an end in itself, but about using competition to improve the community's living standards.