



Competitive Neutrality: A Public Transport Perspective

A presentation by Graeme Samuel
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Introduction

People are talking about National Competition Policy (NCP) as though everyone is familiar with it. Yet the discussion is usually in such generalities that I would not be surprised if many people find it difficult to grasp what it actually means for them or for their industry. What NCP actually means is important for an activity such as the bus and coach industry, which has a significant influence on people's ability to move across both urban and rural areas and between the country and the city.

Passenger transport services in Australia are provided by a variety of public and private sector interests. Government involvement is complex and pervasive, with governments having the roles of service provider, planner, regulator, funder, and infrastructure builder and manager.

Urban rail is generally operated by state government monopolies, buses by a mix of private and public operators but with private operators often operating under contracts which specify routes and fares and so on. Taxis, while run by private interests, are heavily regulated by government licensing bodies. Governments also regulate more broadly, setting road rules and arrangements for vehicle registration and driver licensing. Finally, Governments do things like build and manage roads, rail lines and bus stops.

There is some recognition of the need for greater competition in the delivery of urban passenger transport services. The issue is not so much about ownership, whether public or private, but more about the level of competition and accountability within the system. In recent years, a number of states have brought in new players, as evidenced by Victoria's breakup of its Public Transport Corporation and franchising of passenger transport businesses, and the tendering out of bus and other transport services in other states.

My discussion today will touch on all areas of NCP, but focussing on competitive neutrality which is the issue you asked that I cover today.

I will be particularly looking at the Coachtrans competitive neutrality complaint against Queensland Rail's passenger transport service in South East Queensland. This is the only formal competitive neutrality complaint involving the bus and coach sector of which the Council is aware. The Council is considering the NCP matters raised by this complaint in the course of undertaking the second tranche NCP supplementary assessment report for Queensland, due to be handed to the Federal Treasurer in June this year.

To set the scene, I will start by explaining the objective of NCP and the obligations it places on governments, and the role of the National Competition Council.

What is National Competition Policy

NCP, in a nutshell, is a co-ordinated program for considering whether we should open up restricted markets for the benefit of consumers, retailers and producers. NCP was agreed by governments in April 1995 following the Hilmer review and has been underway since about mid-1996, which is when governments produced their NCP policy statements.

The direction of the policy approach is not really new – since the mid-1980s, all governments have been looking at the efficiency of their businesses and whether their regulations are still achieving what they were intended to. What is new under NCP, however, is the co-ordination of these efforts. The result is a program of reforms directed towards ensuring that the Australian economy is opened to competition, except where it can be demonstrated that it is in the public interest to continue to restrict competition.

NCP, then, is about encouraging a more competitive economy where this will deliver long-term gains for the whole community, rural, regional, urban, business and consumer. NCP seeks to encourage competition, where competition is appropriate, to boost economic performance throughout the economy. However, it is not, and never has been, about competition everywhere, nor competition for its own sake.

The essential elements of NCP are four broad 'generic' reforms which apply to all sectors of the economy and 'related' reforms applying to four specific infrastructure sectors. The generic reforms are to:

- extending the reach of Part IV of the Trade Practices Act to apply to all businesses in Australia. Part IV of the Act contains rules to limit the abuse of market power by businesses, promote fair trading and efficient industry practices, and protect consumers;
- improve the quality of Australia's infrastructure through reform packages in the electricity, gas, water and road transport industries; and by establishing third party "access" arrangements for the services of nationally significant monopoly infrastructure such as gas pipelines, electricity grids and railway lines; the infrastructure reform of direct impact on your industry – road transport regulation – is aimed at greater consistency across the country in regulations affecting vehicle registration, driver licensing, road

safety and operations. This aspect of NCP is relevant to the bus and coach sector because it affects, for example, vehicle registration, driver licensing and management of bus driving hours to combat fatigue;

- review and, where appropriate, reform all laws which restrict competition. The objective here is that governments review all legislation restricting competition by the end of 2000 and remove those restrictions unless they can show that the restriction is in the public interest and is necessary to achieving the objectives of the legislation; and
- improve the performance of government businesses through structural reform and introducing competitive neutrality so that government businesses do not enjoy unfair advantages when competing with private businesses.

The Commonwealth Government makes payments on an on-going basis to States and Territories that achieve satisfactory progress against their NCP obligations. These payments in part recognise that the Commonwealth will benefit from increased revenues through increased productivity. They are economic dividends paid to states and territories in return for the investment in reform. This financial year the payments were worth around \$640 million.

Misunderstandings about the scope of NCP reform are common, no doubt because of the diverse nature of the program. To clarify three important points, NCP does not require:

- privatisation;
- competitive tendering; or
- cuts in government services or reductions in funding of particular activities .

Each of these approaches has been implemented by various governments in recent years, with efficiency considerations in mind. But they are not required under NCP.

The 'community benefit test'

Governments acknowledged, in establishing NCP, that restrictions on competitive behaviour impose costs on the community. As a result, NCP is premised on removal of restrictions on competition. Governments, and those who benefit from competitive restrictions, need to establish the case (in terms of a benefit to the whole community) for retaining or introducing restrictions. Even where there is a benefit in retaining a restriction, NCP requires that the least anti-competitive approach be implemented.

Notwithstanding this, NCP acknowledges that competition is not an end in itself. Thus, while in general competition will deliver benefits to the community, there will be situations where community welfare is better served by not introducing particular competitive reforms.

NCP also recognises that where restrictive behaviour is acceptable to achieve a community objective, there must be a rigorous and transparent process for reviewing the restrictive

behaviour and assessing the balance between its benefits and costs. The Competition Principles Agreement sets out a range of indicative factors, including considerations which are not strictly economic in nature, which are relevant to the assessment of net community benefit. These factors include ecologically sustainable development, social welfare and equity, occupational health and safety, industrial relations, economic and regional development, employment and investment growth, the interest of consumers, the competitiveness of Australian businesses and the efficient allocation of resources.

What is the role of the National Competition Council

The NCC is a policy advisory body. Councillors are appointed by, and report to, both the Commonwealth Treasurer and the Council of Australian Governments (COAG). The Council is five people drawn from private sector and community backgrounds and from different parts of Australia, supported by a small secretariat that provides us with economic, legal and public policy advice. The Council's role, in general terms, is to promote the reform program; to facilitate reform; and to monitor progress by governments in implementing the reform program.

The Council doesn't undertake reviews of anti-competitive laws or investigate competitive neutrality issues itself. Responsibility for this lies with the States and Territories. Neither has the Council jurisdiction to second-guess review recommendations or review the recommendations of competitive neutrality complaints bodies.

The Council's role is to ensure that processes are rigorous – thereby facilitating good policy outcomes – and to see that governments implement review recommendations. For example, the Council tries to ensure that legislation reviews are independent, rigorous and transparent and that the evidence before the review body supports the recommendations reached. This means ensuring that the interests of the community as a whole are the paramount consideration – rather than usually powerful, loud and politically concentrated vested interests.

The Council makes recommendations to the Federal Treasurer on reform progress and consequently on the competition payment dividends that should be made to States and Territories. This is done three times over the life of NCP. The second assessment took place in June 1999 and the third assessment occurs in mid-2001. There were several issues not resolved at the June 1999 assessment which are the subject of a supplementary second tranche assessment in June 2000.

Components of NCP relevant to the bus and coach sector

Competitive neutrality obligations

In the 1995 NCP reforms, governments committed to ensuring that significant public businesses reflect all of their costs in their pricing and to establishing a formal mechanism to address complaints about breaches of the competitive neutrality principles.

By removing advantages such as exemptions from taxes and charges previously available to certain government businesses, competitive neutrality principles remove the capacity of those businesses to undercut their private sector competitors, or to use an artificially low price as a barrier to the entry of potential competitors. This has the effect of ensuring that public and private businesses compete on the basis of their particular strengths.

By encouraging fair competition, competitive neutrality also helps to improve the operation of government businesses. As a result, citizens benefit from more competitive pricing and improved quality of government services. And where taxpayers' funds are no longer used to provide goods and services better provided by the private sector, and remaining government activities are more efficient, a greater proportion of total public funds is available for other priorities, for example, health, schools and welfare.

Under NCP, governments have an obligation to establish a mechanism for investigating allegations that significant government businesses are not appropriately applying competitive neutrality principles and to publicly report on complaints received. All jurisdictions have done this and there have been a range of complaints across jurisdictions. The Coachtrans matter in Queensland, that I referred to earlier, is the only public transport complaint raised to date.

Community service obligations

Community service obligations (CSOs) are often a significant factor in public transport. For example, for safety or environmental reasons, governments might want to utilise CSOs to achieve particular social objectives such as a shift of a particular type of traffic, including passengers or freight, between different transport modes, particularly from road to rail.

A CSO arises when a government specifically requires a business to carry out an activity or process that:

- the organisation would not choose to do on a commercial basis, or that it would only do commercially at higher prices; and
- the government does not, or would not, require other organisations in the public or private sectors to undertake or fund.

The NCP agreements allow governments to provide genuine CSOs. However, there are requirements on governments in terms of CSO costing, funding and interaction with other competitive neutrality obligations. For an activity to be recognised as a CSO, the organisation

delivering the CSO services should be directed explicitly to carry out the activity on a non-commercial basis, for example, by legislation, government decision or a publicly available direction from a Minister.

CSOs should be funded directly from the budget of the government department responsible for the CSO, with costs determined as part of a commercially negotiated agreement.¹ CSO agreements should include similar competitive neutrality requirements as applied to other activities, that is, these activities should be able to pay taxes and earn a commercial rate of return (as if contracted out). The intention is to encourage more effective and transparent provision of CSO services, with minimal impact on the efficient provision of other commercial services.

Using appropriately defined and funded CSOs is consistent with the broad intent of competitive neutrality, which is the elimination of resource allocation distortions which may result, for example, if external costs to the environment or safety are not addressed. This is an important aspect in relation to the Coachtrans matter.

Bus/train competitive neutrality: the Coachtrans case

Coachtrans is a bus company offering passenger transport services, among other places, between Brisbane and the Gold Coast in Queensland.

In February 1996, Queensland Rail (QR) introduced a passenger transport service from Brisbane to the Gold Coast as part of the Queensland Government's response to forecast population growth in the Brisbane - Gold Coast corridor. At the time the QR service was introduced, Coachtrans charged \$11.00 for a single adult fare. QR's price for its service was \$7.20.

Coachtrans lost substantial patronage despite significant fare reductions following the introduction of the QR service. The company lodged a competitive neutrality complaint with the Queensland complaints mechanism (the Queensland Competition Authority) in June 1997. Coachtrans alleged that there was a breach of competitive neutrality in respect of the prices charged by QR and in respect of certain procedural and regulatory advantages enjoyed by QR.

Relevant to this is that QR's operating costs are subsidised by the Queensland Government through a CSO. In 1996-97, the Citytrain network subsidy, which includes Brisbane - Gold Coast was \$369 million. In 1998-99, QR received \$520 million from the Queensland Government to provide transport and employment services.

The QCA reported in June 1998, finding that Coachtrans and QR are in competition in the public transport passenger market from Brisbane to the Gold Coast. The QCA also found that QR receives considerable subsidies and is able to set prices which are below operating costs and make no return on capital. The Authority concluded that the subsidy arrangement is directly attributable to QR being owned or controlled by the Government. In contrast, the

¹ Where direct funding entails unreasonably large transaction costs, Ministers may purchase CSOs by notionally adding to the provider organisation's revenue result, for the purpose of calculating the achieved rate of return. However, there should be no adjustment to the commercial rate of return target of the service provider to accommodate CSOs.

QCA found that Coachtrans receives no subsidies and is required to meet all costs including a return on capital if it is to remain viable over the longer term. Also, the QCA found that QR fares on the Brisbane to Gold Coast route make no contribution to the cost of the track, whereas, on the evidence available, bus operators (in general) fully recover the cost of road infrastructure.

The overall finding by the QCA was that the fares charged by QR for its Brisbane to Gold Coast service breach the principle of competitive neutrality but that QR does not enjoy any procedural or regulatory advantage on the route.

Having found that the prices charged by QR provide it with a competitive advantage (solely as a result of government ownership or control), the Authority, as it is required to do, looked at whether there were any reasons to justify the breach. In particular, it looked to see whether there was evidence that economic, social or environmental costs such as air pollution, road congestion, safety, reduced expenditure on road capacity and provision of alternative means of transport might justify the price differential. While the QCA found some advantages for rail over buses in these areas, it assessed that these advantages were not sufficient to alter the relative total costs associated with the services.

Accordingly, the QCA concluded that the current price relativities did not promote the long term best use of resources in the public transport market (the central objective of competitive neutrality) and that there are no 'public interest' reasons which justify the breach.

The QCA's preferred solution was to rectify the breach through removal of that part of the QR subsidy which cannot be justified by reference to the relative contribution of the two modes to broader economic, environmental and social goals. However, because this may encourage an increase in private vehicle usage to the detriment of the community,² the QCA considered that the Government should establish a CSO framework which reflected the relative contribution of the various public transport modes to the broader goals regardless of whether they are publicly or privately owned. Such a framework would deliver an 'efficient' relative price for bus and rail services.

Because the development of such a framework requires significant information, the QCA recommended that the Queensland Government take the necessary action to establish a CSO framework for the Brisbane to Gold Coast public transport service which complies with the principle of competitive neutrality, achieves efficient resource allocation and promotes competition in the public transport passenger market.

Subsequently (August 1998), the Premier and Treasurer, who in Queensland are the relevant decision makers on this matter, rejected the QCA finding that there had been a breach of competitive neutrality in relation to the fares charged by QR for the Brisbane to Gold Coast route. The Ministers considered that the information available to them was not sufficiently conclusive to support the QCA decision. It appears that the reason for this, based on evidence provided to the Supreme Court of Queensland through an application for judicial review brought by Coachtrans, is that the Ministers considered that the research undertaken by the QCA did not show conclusively that the two modes compete for passengers in the Brisbane to

² Unless QR can reduce its costs or car drivers pay the full cost of using the road.

Gold Coast market. In these circumstances, there would be no case for a complaint about a breach of competitive neutrality. As part of their decision, however, the Ministers committed the Government to developing a CSO framework for the South East Queensland passenger transport market.

The Council considered the implications of the Coachtrans matter as part of its second tranche assessment of NCP progress in June 1999. However, because Coachtrans' application for judicial review was current at the time of the assessment, the Council could not complete its assessment of progress at that time. It advised the Federal Treasurer to defer a decision on Queensland's progress with competitive neutrality and associated competition payments until the application had been decided and the Queensland Government had had time to respond to the decision. The NCC also advised Queensland and the Federal Treasurer that good progress against the commitment to develop the South East Queensland passenger transport CSO would be relevant to the assessment of progress.

The second tranche assessment of Queensland's competitive neutrality performance will be finalised as part of the Council's supplementary report to the Commonwealth Treasurer in June 2000. As I have said, the assessment will focus on progress towards the objective of a clearly defined CSO framework for passenger transport in South East Queensland, consistent with the Ministers' commitment. The Council is likely to conclude that Queensland has not made sufficient progress against its competitive neutrality objectives unless there is evidence that the CSO framework is substantially progressed.

The other focus for the Council in assessing whether competitive neutrality principles are being appropriately applied is whether state and territory complaints handling arrangements are operating satisfactorily. The judgment on this encompasses not only the actual complaints investigation but also governments' decisions on the recommendations of their complaints bodies. The Council is likely to conclude that a jurisdiction is not applying appropriate competitive neutrality principles if there is evidence that a government has rejected several recommendations by complaints bodies without providing a compelling public interest justification.

Other components of NCP relevant to buses and coaches

The NCP road transport reform program

As I have mentioned before, the road transport element of NCP is aimed at creating greater consistency in regulation, in effect treating Australia as a national entity rather than a collection of different states. The second tranche NCP program comprised 19 elements covering, in the main, reforms aimed at standardised heavy vehicle registration procedures, driver licensing requirements and enhanced safety and roadworthiness measures. The Combined Driving Hours Regulations provide nationally consistent legislative and administrative arrangements for managing bus and truck driver fatigue.

The process from here is that the National Road Transport Commission, working to Transport Ministers (the Australian Transport Council), will develop the third tranche NCP reform

program for road transport. The third tranche program, which the states and territories will be required to put in place, will be available around February 2001.

Let me now briefly cover two issues that may be of direct relevance to the transport industry.

Regulating the taxi industry

Currently, taxi licence numbers, taxi fares, taxi co-operatives and hire cars are highly regulated in all Australian States. Restrictions on the issue of licences have seen their price increase enormously in the last ten years, up to around \$280 000 in Sydney. This means that, before a potential taxi licensee can even buy a taxi, she or he must pay \$280 000 for the privilege of obtaining a licence.

Review after review has found that this restriction of licence numbers offers few community benefits and significant community costs. The costs include higher taxi fares, longer waiting times and no incentive to offer different and innovative services. Employment opportunities are lost, and drivers without licences have almost no opportunities to purchase one and run their own taxi businesses. Indeed, restrictions on the taxi industry can prevent it from competing with other segments, including hire cars and local bus routes.

Removing restrictions on the taxi industry, opening it up so that the privileges of existing participants are exposed to proper competitive pressures, is complex.

Dealing with licence plate values is undoubtedly the most difficult issue. Matters such as how fast to remove restrictions, whether compensation should be paid to existing licence holders at all, and if so to which ones and how much are all relevant.

Governments may consider compensation that distinguishes on the basis of investor type, how long the licence has been held and price paid for the licence. For example, many investors in licences are of significant size, and understood the risk of making an investment in taxi plates, that is, that governments may one day place the interests of the community generally ahead of their interests and remove unnecessary restrictions on plate numbers. Many of these investors have enjoyed the benefits of restricted competition for a long time, and have seen the value of their taxi plates rise solely because numbers have been restricted by governments. The case for compensating these licensees is weak.

If there is to be any compensation, governments may consider mechanisms such as temporary licence fees or fare levies to fund one-off payments. Alternatively, governments may decide to deregulate over a period of time, and perhaps include in this some element of compensation funded by licence sales. Doing nothing to the taxi industry is unlikely to satisfy NCP reform commitments. However, because there are very significant benefits to be had by the whole community, governments should take this opportunity to usefully reform the taxi industry.

Structural reform of public transport monopolies

The NCP structural reform obligation applies when governments are considering introducing competition to markets traditionally supplied by a public monopoly and prior to privatisation of public monopolies. Where they are considering either of these actions, governments have undertaken to remove any regulatory responsibilities from the monopoly so that it has no regulatory advantages over its existing and potential competitors. Reform may also involve splitting any monopoly elements of the business from the potentially competitive elements in

order to avoid the risk of unfair competition via cross-subsidisation from the monopoly activities. Structural reform is particularly important where a monopoly is to be privatised.

The recent changes in Victoria provide an example as to how increased competitive pressures can be brought into public transport systems. Until 1993, Victoria's Public Transport Corporation (PTC) provided a significant part of Melbourne's public transport services. In December 1993, following a public tender process, the National Bus Company took on responsibility for about three-quarters of the PTC bus service. The National Bus Company purchased buses and leased depots under a 10 year patronage-based incentive contract. In April 1998, again following a public tender process, the Melbourne Bus Link Company took over the remainder of the PTC services and purchased the remaining buses under a 10 year contract.

During 1997 and 1998, V/Line Freight and five separate corporations were created to provide metropolitan train and tram services and country rail passenger services. V/Line Freight has now been sold and the five businesses franchised to the private sector. Public transport industry regulation is now fully separated from service provision, including a Public Transport Safety Directorate whose function is to regulate safety across all public transport modes.

Summing Up

The NCP reforms are about removing barriers that have protected various businesses and industries from having to provide quality goods and services at competitive prices. The aim is to use Australia's resources better and to ensure that Australian industries can compete vigorously on world markets. However, while new or wider markets are in prospect, benefits will be won only if Australia's industries are competitive against those of other nations.

From a national perspective, NCP helps in a number of ways, for example, by reducing the cost of business inputs, improving the efficiency of government businesses and raising the productivity of infrastructure. Recently we have seen evidence of these improvements starting to come through. For example, Australia's annual productivity growth averaged 2.4 per cent over the last six years, a rate matched only by Norway among the world's developed nations.³ IMF and OECD reports have also linked the recent strength and resilience of the Australian economy – including several years of sustained economic growth and declining unemployment – with structural reform policies like NCP.

The evidence from the early reforms, in summary, is that there is much to be gained by governments pushing ahead with robust reform programs.

Inevitably, however, there are opponents. While there is an overall benefit to the community, vested interest groups which have been hitherto protected from competition are threatened,

³ Parham, D. 1999, *The New Economy?: A New Look at Australia's Productivity Performance*, Productivity Commission Staff Research Paper, AusInfo, Canberra, May.

and the effect of reform and need to adjust impinges more heavily on some groups than on others. Some people will seek to exploit these points, and misunderstandings within the community about the effects of competition reform, for their advantage. Politicians will come under pressure as a result, and this pressure encourages backsliding from the NCP agenda. Having said that, the Council understands that some parts of Australia are facing difficult times. While most of the underlying causes have little to do with NCP, it is true that NCP in some cases is creating added strains.

Dealing with this is a challenge for governments and for the NCC. For its part, the NCC is committed to working towards achievement of the package of reforms agreed in 1995. This means working with governments to implement their programs but also using the pressure that can be brought to bear through the Council's assessment function and the competition payments to ensure that reforms which are in the community interest are put in place. That means dealing appropriately with the more difficult questions, including establishment of CSO arrangements consistent with competitive neutrality principles and taxi industry regulation issues.