Microeconomic Reform and Competition Policy

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Introduction

Two major reports on National Competition Policy (NCP) have been released in recent months. The Productivity Commission published its report on the *Impact of Competition Policy Reforms on Regional and Rural Australia* in September 1999. And earlier this month, the Senate Select Committee on the Socio-Economic Consequences of NCP released its findings. The reports share a good deal of common ground. In particular, they emphasise that many parts of rural and regional Australia have suffered a cumulation of socio-economic traumas in recent decades.

The reports also highlighted that people in rural and regional communities tend to associate National Competition Policy with these traumas. NCP is often seen as a vehicle to cut rural services, abolish farming co-operatives and slash employment opportunities. There are also widespread suspicions that NCP is designed to benefit city people and big business at the expense of rural Australia.

But as the Productivity Commission points out, the hardship facing many parts of rural Australia has relatively little to do with NCP but reflects changes in the structure of the Australian economy over several decades. The key factors have been declining commodity prices, improvements in farm productivity, and a population drift towards larger regional centres and the cities. In combination these factors have severely limited business opportunities in rural Australia, resulting in things like bank closures and the loss of town GPs.

But it's also true that NCP is having its own impacts – both positive and negative. What I would like to do in the next few minutes is to outline some of these impacts. Before doing so, I should provide an overview of what exactly is encompassed under NCP.

Background

The National Competition Policy reforms, agreed by the Commonwealth, State and Territory governments in 1995, are to:

- *improve Australia's consumer protection laws* by extending the reach of Part IV of the Trade Practices Act (TPA) 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;

- *review and, where appropriate, reform all laws which restrict competition*, and ensure that any new restrictions provide a net community benefit; 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 diverse nature of the NCP program is no doubt one of the reasons why misunderstandings about the scope of reform are common. To clarify three important points, NCP does *not* require:

- privatisation;

- competitive tendering; or

- cuts in government services.

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

The NCP reforms are about removing barriers that traditionally protected various businesses and industries from having to provide quality goods and services at competitive prices. The aim is to make better use of the nation's scarce resources and to ensure that Australian industries can compete vigorously in the globalised economic environment. While globalisation offers the benefit of opening up new or wider markets, these benefits are only attainable if Australia's industries are competitive against those of other nations.

Some of the ways that NCP helps in sharpening competitiveness is 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 benefits starting to come through. For example, Australia's annual productivity[1] growth averaged 2.4 per cent over the last six years, a rate matched only by Norway among the world's developed nations.[2] 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.

At the same time, many NCP reforms are tied to independent *public interest assessments* to ensure that each reform brings a net benefit to the community. These assessments take account of such matters as:

- environmental considerations;
- social welfare and equity considerations, including community service obligations;
- regional development and employment;
- consumer interests;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

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1 Multi-factor.

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

NCP and Rural and Regional Australia

I'd like to move on now to some of the areas of NCP affecting rural and regional Australia. The areas I will cover are:

- *local government* reform.
- the review of legislation governing *statutory marketing arrangements*.
- the review of *legislation affecting the provision of services* in rural and regional Australia.
- *water* reform.
- reforms affecting infrastructure services like energy, rail and telecommunications.

Local government reform

Local government is the closest level of government and hence highly visible to the community when it comes to implementing competition policy – especially in remote and rural areas.

Concerns were expressed to the Senate Select Committee and to the Productivity Commission inquiries that *competitive tendering reforms* applied by local governments in rural and remote communities were destroying employment opportunities.

To reiterate my earlier comments, NCP does *not* require competitive tendering. This is strictly a matter for governments. What *is* required is competitive neutrality reform, where this brings a net public benefit. Competitive neutrality involves governments reviewing how their businesses engage in commercial activities to ensure fair competition between public and private businesses. This will mean that optimal use can be made of scarce resources, bringing benefits to both councils and ratepayers. Clearly this can bring benefits to councils both in urban and rural Australia.

Sometimes governments have used competitive tendering as a way of implementing competitive neutrality, but it is not the only way. Other approaches to competitive neutrality include commercialisation and more rigorous accounting procedures.

Where governments choose to use competitive tendering, it *can* bring benefits if it is properly applied. The trick is that the outcomes are only as good as the process followed. The type of concerns we have heard is that small service providers in the bush are sometimes unable to compete with big service providers based in larger markets – meaning job losses in the local area. For example, there have been cases of road work being tendered out to 'fly-in-fly-out' operators from the city, who can't provide an ongoing service, but put local people out of work in the meantime. Such costs need to be taken into account.

Competitive neutrality reforms should be implemented in ways that bring a net community benefit. For example, if a local government decides to run a tender for its roadworks, it is just as important for the selection process to look at things like the impact on local commerce and employment, service quality and environmental impacts as it is to look at cost savings to ratepayers. A tendering process that looks no further than relative price is a flawed process. Instead, a certain amount of innovative thinking may be required. In this way, well-targeted competitive neutrality reforms can be used to the benefit of local communities.

As an example, the Noosa Council in Queensland recently ran a 'build and operate' tender for waste water services, following a twelve month period of community consultation. The Noosa Council found that this approach was the best way to manage risk given its intention to use leading edge technology – about which the council staff had little knowledge – to minimise potential environmental damage. The Noosa Council commissioned an independent costs estimate prior to inviting bids, and finally selected a tender that saved the local community around $3 million. At the same time, the Council offered its existing staff options for relocation within the organisation – with retraining – or employment with the successful bidder.

It should be emphasised that NCP is not a 'one size fits all' approach. The framework takes account of the great diversity in Australian local government units – in terms of size, organisational structure and service responsibilities – by conferring considerable discretion on governments as to how reform should be implemented in the best interests of the community.

In Victoria, for example, compulsory competitive tendering preceded the NCP changes. It required a phased shift towards 50% of all local government expenditure being subject to competitive arrangements. The approach in Queensland has been more gradual, with a shift towards commercial principles matched by measures to restrict the erosion of jobs and community capital in local areas. This is a particularly important issue for Queensland, where local governments are responsible for more services than they are elsewhere in Australia.

Queensland has adopted an approach akin to 'commercialisation' of local government business activities, with 'in-house' service providers receiving training and skills upgrades to put them in a competitive position with external contractors prior to the use of tendering processes. This approach is sharpening the efficiency of service provision, and promoting the retention of jobs. Funding for these initiatives comes as part of a series of targeted transfers from the State Government over five years, totaling up to $150 million.

Queensland's approach offers the potential for better value for money in local government services, while providing council staff with appropriate adjustment assistance. Given the size of Queensland's local government sector, the shift towards greater use of competitive tendering and commercialisation without going through this up-skilling process could have led to harsh unemployment pools being created in parts of the State. By going through this process, however, this risk has been minimised.

Statutory marketing authorities

An important area of the legislation review program for rural communities is the review of statutory marketing arrangements. SMAs are centralised marketing boards, often with powers to compulsorily acquire or vest an entire crop, set quality grades and prices, and act as the single seller on the domestic and/or export markets. SMAs are up for review because they are prima facie anti-competitive – producers can sell their product only to the marketing body and customers can buy the product only from the marketing body.

This is a controversial area because many people are concerned that reforming these monopoly arrangements will benefit city dwellers – through cheaper farmgoods – at the expense of rural communities.

For anti-competitive arrangements to be retained, it must be demonstrated that the benefits to the whole community, including primary producers, outweigh the costs, and that the benefits to the community cannot be achieved without the arrangement.

The main argument usually put forward in support of SMAs is that, in certain circumstances, they may be able to create a degree of market power that enables higher prices to be earned for farmers in export markets. But there are costs. SMAs also constrain individual farmers from making their own production and marketing decisions, sometimes to their detriment. Earlier this month, for example, around 150 durum wheat farmers were rallying to take on AWB Ltd in court because the single desk exporter was refusing to let private traders sell the season's rain damaged crop to overseas buyers.[3]

In addition, allowing an SMA to control both export *and* domestic markets can impose costs on domestic consumers, especially where import restrictions apply on the domestic market. A likely consequence of forcing up domestic prices above export prices is to send processing and value-adding activities overseas – along with jobs that could otherwise have been kept in Australia, often in rural communities.

There is also evidence to suggest that the perceived benefits of SMAs may be overstated. A number of important agricultural industries – such as cotton, winegrapes and red meat – have prospered *without* statutory marketing monopolies.

Recent independent reviews into SMAs indicate that there is no single best approach to marketing agricultural goods. The reviews to date have proposed a range of approaches to reform, targeted to the circumstances of each industry, with benefits to both rural communities and consumers generally.

For example, reviews of marketing arrangements for *rice* and *sugar* recommended retaining a single marketing board's exclusive right to trade the commodity on *export* markets – where this can help boost farmers' incomes. At the same time, these reviews have recommended measures to ensure that *domestic* customers are not disadvantaged – and that investment and jobs in the Australian food processing industry are not discouraged.

However, a review of *barley* marketing found that farmers and consumers would benefit most by giving farmers freedom of choice as to how they sell their crops on both local and export markets.

The Council has endorsed each of these approaches. In fact, the Council's focus relates primarily to the review *process* rather than the specific outcomes in each case. Given the potential for a range of vested interests in the outcome of a review, it is important that reviews of marketing arrangements be independent and rigorous to ensure that the findings are objective and take account of costs and benefits of reform from the interests of the community as a whole – including primary producers, consumers and rural communities. In this way, it becomes possible to look at ways of achieving the maximum benefit for both rural *and* urban communities.

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[3] Reported in *The Land*, 3 February 2000.

It should be noted that where a review recommends the removal of compulsory marketing arrangements, farmers may develop voluntary arrangements for collective marketing. The Trade Practices Act imposes no barriers to collective marketing on export markets, while primary producers can apply to the ACCC for authorisation of voluntary collective marketing arrangements on the domestic markets. As a related development, we are starting to see a number of mergers and restructurings in grain industries. For example, VicGrain and GrainCorp announced a merger last year to capture economies of scale and greater market clout.

Rural services

Apart from the review of SMAs, a range of other legislation affecting rural Australia is being reviewed – such as legislation affecting the professions, retail services such as petrol and pharmacy products, and essential services such as post and telecommunications.

There are widespread concerns that reforming legislation governing the supply of services such as petrol and pharmacy products may result in an expansion of services in larger regional centres at the expense of small businesses in outlying rural and remote communities. These are legitimate concerns that should be taken into account in cost-benefit assessments of whether reform is justified in the public interest. One problem seems to be that some public interest reviews have been lacking in transparency and openness – an issue noted both in the Senate Select Committee and Productivity Commission reports. Reviews that lack genuine public input and transparency, or which fail to take into account the likely distribution of costs and benefits, can only arouse suspicions of unfair play.

The loss of services in parts of rural Australia reflects an interplay of factors I mentioned earlier – dwindling populations and declining business opportunities stemming from a long-term decline in commodity prices and improvements in farm productivity.

But regulatory reform can also be a factor in some instances – for example, regulatory reform in the supply of petrol may result in the closure of some petrol stations in outlying communities, with supply becoming more centralised in larger regional centres. This is likely to make petrol cheaper in the bush – due to the economies of scale available in more centralised supply. However, it may also impose socio-economic costs in terms of the loss of a valued service or shop which provides both commerce and a focal point for a small community. In other words, a common scenario is a more centralised service – which may be better than that previously provided – but with less ready access for people in outlying areas.

Conversely, there is evidence that regulatory reform can *improve* access to some services in rural areas, by removing overly rigid barriers to supply. For example, declining rural populations have threatened the availability of services such as doctors, solicitors, physiotherapists and optometrists in many communities. But regulatory reform, such as removing the monopoly enjoyed by lawyers over conveyancing, has reduced conveyancing fees and promoted greater access to conveyancing services.

Deregulation is also making a number of other professional services in rural areas cheaper and more accessible. For example, a Victorian review into barriers to entry in optometry has resulted in professionals with a narrower band of qualifications gaining the right to conduct certain services – such as eye testing – that were previously limited to optometrists. The result is that people in rural communities will gain access closer to home to a number of services that once required travel to a large regional centre.

Deregulation of shop trading hours has also brought benefits to rural consumers in terms of greater convenience as to where and when they can shop. A 1998 referendum in the Victorian city of Bendigo found that of the 72 per cent of eligible voters who participated, 77 per cent voted to maintain the newly deregulated Sunday trading arrangements. Despite fears that deregulation would damage employment, retail employment in Victoria increased by 5500 people between February 1997 and February 1998 – the period following deregulation, and has continued to rise steadily since.

Finally, reviews of pharmacy arrangements and other retailing restrictions may increase pressure on some small rural businesses, but may help others survive and grow by allowing businesses to combine to reduce costs and increase revenue.

Water

Another significant area of NCP for rural communities is water reform. At first glance, the traditional approach of subsidising water prices for households and irrigators appears to have helped rural communities – irrigated land produces around a quarter of Australia's agricultural output and sustains employment in dozens of rural towns.

But the cost has been high, with many of the costs being borne by rural communities themselves. Overconsumption of 'cheap' water has contributed to a range of environmental problems. As the demand for water has risen, governments have built more dams and allowed increased diversions from rivers – but with water charges not covering costs, water authorities have lacked sufficient funds for maintenance. The outcome is deteriorating water quality in parts of the country, salinity problems in many farming areas such as the Murray-Darling Basin, stressed rivers, with outbreaks of blue-green algae and damage to native fish populations and local ecosystems. South Australia has suffered particularly badly, with its main water source – the Murray – having become degraded and depleted by over-consumption in upstream states. Clearly, the era of cheap water is no longer sustainable.

The water reforms aim to halt the degradation of this natural resource through a framework based on principles of economic and ecological sustainability. The rural water reforms are being phased in over seven years or more, to give rural businesses and communities plenty of advance notice and time to plan and adjust. The reform process also requires significant involvement by farmers and rural communities.

The importance of water reform can be gauged from the example of Victoria, where the fresh and processed food industry is now the State's biggest industry with exports worth close to $8 billion per year. Yet the sustained health of this largely rural-based industry is dependant on secure supplies of water and addressing problems like salinity.

A central reform is the shift towards *full cost recovery* in rural water pricing. This will result in some water charges being increased, to encourage people to economise on their usage and to provide more funds for maintenance. Bulk water prices are increasing the most in states like New South Wales, where prices have traditionally been far lower than in neighbouring states.

The Council has emphasised how important it will be for governments to look at adjustment assistance to help farm businesses adjust to these changes. NSW has been a leader in this area, with its $33 million structural adjustment package. The package targets farm business planning, irrigation skills training, financial assistance for water-efficient techniques and technologies, and re-establishment assistance, where required.

While the water reforms will impose pain on some rural businesses, important benefits will flow from the new system of secure water allocations coupled with permanent trading in water. Water rights are being allocated to individual farm businesses, with caps on total diversions from rivers to protect the environment. Farmers are then free to sell their water rights to others who can use the resource more effectively.

For example, a farmer may not own land suited to growing high value crops, and may get a better price by selling part of their entitlement to another farmer with more suitable land characteristics. Conversely, farmers who believe they can use extra water effectively can go out and buy bigger allocations.

In essence, water trading will encourage a shift away from crops which use a lot of water for poor returns, towards higher value crops and sustainable wealth generation in rural communities.

An indicator of the potential for water trading to improve farm sector profitability can be gleaned from the differences in returns per megalitre of water between different farm outputs. Work by the Murray Darling Basin Commission for 1993-94 found that average gross margins per megalitre ranged from about $100 and $120 for soybeans and lucerne respectively, through $180 and $200 for rice and wheat, $550 for tomatoes and over $1000 for winegrapes.

These figures suggest that water transferred out of broad-acre cropping into winegrapes or stonefruit, for example, will boost rural profitability. In Victoria, water rights are now being traded from traditional land uses such as sheep and beef cattle to higher value industries such as wine making and horticulture. In the State's horticulture and dairying industries alone, the projected benefits of intrastate water trade are about $50 million a year in additional agricultural output. New jobs are being created, bringing unemployment in the Goulburn-Murray region down to under 5%. Across the border, 11.5 per cent of water entitlements in New South Wales were traded in 1997-98. The net present value of the increase in the value of irrigated agriculture resulting from these water trades was around $65 million.[4]

Trading *between* States is also being introduced. The first permanent interstate trade was finalised in September 1998 – a 249 megalitres transfer between a citrus orchard in Wentworth, NSW to a grape enterprise in Nangiloc, Victoria. The citrus farm was using up to eight megalitres of water an acre, but the Nangiloc development will use only 2.5 megalitres per acre. Interstate trade will bring substantial benefits – especially in drought years. Traded water will help preserve the highest value crops, which will be of national as well as State and regional benefit.

Other infrastructure

Competition reforms in other infrastructure areas has brought a mixture of costs and benefits to rural Australia. Reforms in the electricity, gas, rail and telecommunications sectors have resulted in significant job losses, to some extent reflecting the removal of overmanning which had developed while government businesses were protected from competition.[5] The majority of job losses in

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4 Marsden Jacob Consulting Economists 1999, *Water Trading Development and Monitoring*, April.

5 Productivity Commission 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia*, September.

electricity and rail have been in country areas – such as Victoria's Latrobe Valley – while job losses in gas have been more pronounced in metropolitan areas. The impact is relatively evenly spread in telecommunications.

On the positive side, energy reform has delivered significant cuts in power bills for those businesses covered by the national electricity reforms. Meanwhile, gas haulage prices in Western Australia are set to fall by 19 per cent, and by up to 60 per cent in NSW by the end of 2000. To date, the bulk of these benefits have been reaped by large industrial consumers. But with the phased energy reform timetable now underway, small businesses and households, including rural co-operatives and farmers, will soon have access to cheaper electricity and gas.

The Productivity Commission pointed out, however, that prices for some users will remain dependant on the maintenance of community service obligations. Another point noted was that service levels to Telstra's customers in rural and regional Australia remains patchy.

A significant benefit to rural Australia has been the decline in rail freight rates and port authority charges. For example, freight rates in Western Australia have fallen by around 42 percent in real terms since deregulation in 1991-92, and by around 13 percent in Queensland.[6] Meanwhile, rail freight rates for the Perth - Melbourne route fell by 40 percent, and service quality and transit times improved, following the introduction of competition in 1995. Similarly, third party access reforms have enabled coal freight charges in the Hunter Valley to fall by 25 per cent between 1995 and 1998, with further cost reductions since then. Meanwhile, port authority charges fell by 23 per cent between 1991-92 and 1996-97.[7]

Equitable outcomes

NCP is one of a suite of policies contributing to Australia's strong economic performance in the late 1990s. But while the process of NCP reform is bringing benefits across the broad spectrum of the community, some groups – particularly those who have been sheltered from competitive pressures – are facing a difficult period of change.

It is important that the benefits of NCP and like reforms be shared fairly across the community. In particular, governments must look at ways of helping

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6 Productivity Commission 1998, *Performance of Government Trading Enterprises 1991-92 to 1996-97*.

7 National Competition Council 1999, *Annual Report 1998-99*.

individuals and communities in the front-line of change to adjust to changing circumstances and ensure that the fabric which binds local communities is not damaged.

To achieve these goals, NCP must be implemented in conjunction with policies that address the distributional impacts of change. This requires structural policies, such as education and training, to better prepare individuals for change. Education is both a means of sustaining innovation and growth, and for disseminating the benefits of change across the community – by enabling people to develop the skills needed to obtain employment in a changing economic environment.

Also important are measures to address the effects of change on individuals and local communities – for example, social security policies, the provision of important community service obligations and targeted rural and regional development policies.

Conclusion

Recent reports of economic boom times in Victoria's Goulburn Valley are a timely reminder that rural Australia is a long way from being dead and buried. Some regions are doing a lot better than the mainstream press would have us believe. Tourism is expanding along the coasts, creating a pivotal new growth industry. The wine growing regions in many States are doing well. And provincial 'sponge' cities all over the country are becoming important economic centres, albeit in some cases at the expense of outlying towns.

Having said that, the Council understands that significant parts of rural Australia are facing difficult times. While most of the underlying causes have little or nothing to do with NCP, it is true that NCP may, in some cases, be creating added strains. At the same time, we should not lose sight of the fact that NCP, if transparently and objectively applied, can bring a lot of benefits to all regions of Australia, including regional and rural communities. In communities where resources are already stretched thin, NCP can provide ways of getting better value for money out of scarce local government finances and may help increase access to a range of professional services. The water reforms offer a blueprint for sustainable water supplies in rural Australia, and the water trading arrangements are helping to underpin new wealth generation in many parts of the country. And the early signs are that the reform of SMAs can both benefit consumers while providing a shot in the arm to rural industries like food processing.

From an national perspective, NCP is adding to Australia's productivity and GDP growth and helping to keep down inflation. These are major achievements. But it is just as important for the benefits to flow equitably. And while some of the aggregate benefits are now being reaped, other policies must be brought in to help address distribution issues. This requires some innovative thinking to ensure that adjustment assistance helps those directly affected by change, without losing the significant benefits accruing to the community at large.