



# National Competition Policy: looking forward

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## Introduction

Four years ago, the Commonwealth and all State and Territory governments agreed to implement the most broad-ranging program of micro-economic reform ever attempted in Australia. The National Competition Policy (NCP) program entails a raft of reforms which seek to extend the productivity-enhancing effects of competition, where it is appropriate, to virtually all sectors of the economy. The primary aims are to lower business costs, enhance competitiveness and provide the conditions for more sustainable economic and employment growth.

When adopting the NCP package, governments also established the National Competition Council to assist with various aspects of the process. Today, I want to discuss the rationale for the program, how far we've come, what remains to be done (including for local government), and how the Council approaches its responsibility to ensure that the program is implemented properly.

My discussion today will cover four broad areas.

- Discussion of the background to NCP and a summary outline of the reforms;
- A description of the role of the National Competition Council.
- The National Competition Council's assessment of where Australia has got to in the NCP process to date, including in those areas most relevant to local government.
- What the National Competition Council is looking for over the final phase of the program, including for local government.

## Background to the NCP reforms

The NCP program can be seen as a response to several broad developments.

One is the increasingly difficult economic circumstances facing Australia in recent decades. In the post-war years, full employment, low inflation and 4 percent annual growth were the norm. But since the mid 1970s, we've been beset by various economic problems and shocks in one form or another. More recently, the Asian crisis has put pressure on our trade performance and exchange rate. And from once having the highest material living standards in the world, by 1996 we had slipped down to 19th position according to the World Bank's index. As our economic performance has waned, so pressure has mounted on governments to act to reinvigorate the economy.

But we have also found that the 'macro-economic' levers that seemed to work in the past are no longer sufficient. Fixing the economy is no longer simply a matter of increasing government spending, or adjusting wages, or changing interest rates.

Policy-makers have thus increasingly turned their attention to addressing problems at the 'micro-economic' level — that is, at the level of individual markets and individual industries. In an increasingly global market place, improving our business competitiveness at the micro-economic level is seen by many as vital to our long term economic success.

Governments started addressing these matters from around the mid-1980s, but early efforts were not always well balanced or coordinated among the three levels of government, and failed to address the full range of anti-competitive restrictions which existed throughout the economy.

It was against this background that, in 1992, Professor Fred Hilmer was asked to examine the need and scope for a more comprehensive, national approach to competition reform matters. This put in train an agreement, supported by all governments in Australia, to implement the NCP reforms.

The NCP reforms involved:

- changes to the Trade Practices Act, mainly to reduce the scope for market rigging, which extend coverage of the TPA to State and local government businesses;
- anti-competitive legislation and regulation, which is to be reviewed and, where appropriate, reformed by the end of 2000;
- the competitiveness of markets involving government-owned businesses, which encompasses the application of competitive neutrality principles, restructuring of public monopolies and independent prices oversight of public monopolies;
- the efficiency of infrastructure use and provision (such as gas and electricity) through a legal regime to provide for third party access; and

- progress pre-existing decisions to create national markets in gas and electricity, reform Australia's water industry and create a uniform and consistent national regulatory framework for road transport.

The NCP program is set out in three intergovernmental agreements signed in April 1995: the Conduct Code, the Competition Principles Agreement and the Agreement to Implement the NCP and Related Reforms. The Competition Principles Agreement is the vehicle through which the NCP program is applied to local government.

The program is due to be completed by 2001, so we are now two-thirds through.

## **The functions of the National Competition Council**

The Council has two main functions.

One of these deals with a very specific area of NCP — namely, the 'national access regime'. This regime is contained in a new part of the Trade Practices Act — Part IIIA — and is one of the one-off changes introduced when NCP started in 1995. The regime is designed to promote competition by enabling businesses to get the use of other business's nationally significant infrastructure provided certain conditions are met, on a commercial basis, so avoiding unnecessary duplication of infrastructure. Much of the activity so far in relation to Part IIIA has centred on rail transport, both operators seeking declaration of particular services and governments seeking certification of their rail access regimes.

The second main function is the one I alluded to earlier and relates to the NCP program in its entirety. As part of the 1995 NCP Agreements, the Commonwealth agreed to pay the States and Territories some \$16 billion over the period to 2005, provided they make satisfactory progress on implementing their NCP reforms.<sup>1</sup> The Council's role is to assess how well the States and Territories have gone and, on the basis of those assessments, recommend to the Commonwealth Treasurer on payment of each State and Territory's NCP monies. The Council has just handed its second assessment to the Treasurer.

The Council also has some other functions, such as informing the community generally, representative groups and specialist policy makers about NCP, and providing advice to governments on aspects of implementation, as and when they request it.

In discharging its responsibilities, the Council's activities are underpinned by the concept of the public benefit. The principles contained in the NCP agreements all turn on the idea that reform should occur where it is in the overall (net) public interest. While the public interest is not explicitly defined, the NCP takes a wide view of what constitutes the public interest,

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<sup>1</sup> The 1995 NCP Agreements provide for around \$16 billion. The introduction of the GST and the actual rate of inflation will affect the actual figure.

including the environment, employment, regional effects, business viability, consumer interests and the competitiveness of industry. Specific reform proposals must be put through a 'public interest test', to weigh up the pros and cons of the proposals and ensure that the community as a whole will be better off, before they are implemented.

Hence, and contrary to the way that some commentators and governments portray the Council in public debate, the Council is not a bunch of deregulatory zealots bent on imposing competition on everything that moves, irrespective of the consequences. In fact, the Council doesn't actually implement any competition reforms itself. This is the responsibility of the various governments. The Council's role is to encourage and facilitate pro-competitive reforms, *where it is in the public interest*, in line with governments' commitments under the NCP agreements.

## State of NCP reform

Let me turn now to how the NCP program is actually going.

As I mentioned earlier, we are two thirds of the way through the implementation phase of NCP. The National Competition Council has just completed the second of three progress assessments. We are thus starting to see some of the outcomes of the process, as well as some of the areas which require continued attention and effort.

### Positive outcomes

There is a range of positive outcomes across various sectors of the economy from applying competition:

- infrastructure reform:
  - commencement of the national electricity market = with price reductions of up to 30% for Victorian and NSW businesses and a fall of around 23% for wholesale prices in Queensland;
  - establishment of the national gas access regime = prices for major industrial users falling by 50% after deregulation of the Pilbara market in 1995;
  - a reduction (in real terms) of Perth-Melbourne inter-state rail freight rates of 40%, and with improvements in service quality and transit times;
  - pricing reform has contributed to an 18 per cent reduction in water prices to Victorians, a 20 per cent decline in water use in Brisbane and real water costs for businesses in Western Australia falling by almost 50 per cent between 1992–3 and 1997–8.
- professions reform:
  - conveyancing fees in NSW fell 17% between 1994 and 1996 after the abolition of the legal profession's monopoly and the removal of price scheduling and advertising restrictions (a consumer saving of at least \$86 million);

- government business reform:
  - prices for the outputs of government trading enterprises fell substantially between 1991/92 and 1995/96 and payments to governments doubled (due partly to competition policy);
- agricultural marketing reform:
  - Victoria and South Australia have passed legislation to free up both domestic and export barley marketing arrangements by mid-2001 and to privatise the Australian Barley Board – providing greater choice and opportunities for producers, traders and consumers;
- streamlining of business licensing;
  - following a review, NSW repealed 72 licence categories, with another 13 being considered for repeal, and has made changes to reduce red tape and provide for more certain and consistent decisions on development proposals.

### Areas requiring attention

The Council's second tranche assessment, completed in June this year, identified three areas where further attention is warranted.

First, the legislation review program has presented some challenges to governments and the Council, and this is likely to continue. Overall, about half the reviews on governments' agendas have been completed or are underway, while only around 20 per cent of the reform agenda is complete. While this has meant that an impressive number of reviews have been conducted within a short period, it also highlights the task ahead: many reviews are yet to commence while large numbers are yet to progress to policy response stage.

The Council's third tranche assessment will necessarily cover some difficult reform areas identified during the second tranche process, such as remaining agricultural marketing arrangements, retail trading arrangements (including liquor licensing arrangements), taxi licensing, the regulation of the professions (including retail pharmacy arrangements) and mandatory insurance arrangements (such as workers compensation and transport accident insurance). This is not an exhaustive list, and doubtless other areas will be identified as the review program proceeds.

Second, on road regulation, governments endorsed a 19 point reform package, brought forward by the Australian Transport Council (ATC) in December 1998, to establish a nationally consistent regulatory framework for heavy vehicle registration, driver licensing, heavy vehicle mass and loading restrictions, commercial driver fatigue management and the national exchange of vehicle and driver information. Only NSW and Victoria had completed all their reform obligations by June 1999. All other jurisdictions were well on track and expected to meet their objectives by January 2000. The Council will undertake a supplementary progress assessment prior to March 2000 to ensure that this has occurred.

Third, water reform. This has been a major focus of governments' NCP implementation activity over the past two years. Local government is a significant player in the Australian water industry. In three States – NSW, Queensland and Tasmania – local governments are heavily involved in water and sewerage businesses, and consequently have responsibilities under the COAG program. For example, in Queensland, along with the State Government, water supply is provided by 124 local governments, four urban water boards, two joint local government authorities, and 55 rural water and drainage boards.

The water reform program dates from 1994, when the Council of Australian Governments agreed that action needed to be taken to arrest widespread natural resource degradation occasioned, in part, by water use, and that governments needed to address the economic, environmental and social implications.

The program encompasses urban and rural water and wastewater industries and includes both economic and ecological objectives. It includes obligations to:

- set prices for water based on the principles of consumption based pricing, full cost recovery and the removal or publication of subsidies or cross-subsidies (for urban water services by 1998 and rural services by 2001);
- implement comprehensive water allocations separated from land title, including for the environment, to facilitate trading in water;
- separate the roles of service provision from resource management, standards setting and regulation;
- invest in new rural water schemes and extend existing schemes only where economically viable and ecologically sustainable;
- implement integrated catchment management and water quality guidelines; and
- educate Australians about the need for water reform.

As a consequence of the NCP reforms, urban water is in general now priced to encourage efficient water service provision and use. As a result, residential and commercial consumers pay only for the water they use. And water providers are now more accountable for the quality and cost of water and sewerage services.

Furthermore, the introduction of tradable water entitlements, separate from land rights, provides the scope for water to be reallocated to its highest value use. It allows producers to purchase entitlements from current users rather than obtain water by increasing diversions from already stressed water systems. Thus, the reform package directly acknowledges the environment as a legitimate user of water.

However, as with any public policy of this magnitude and complexity, implementing the water reform package has not been without its difficulties. There have been some slippages in implementation which will be the subject of supplementary second tranche assessments over the next 12 months. In some cases, these are relevant to local governments as discussed below. In addition, 25 per cent of Queensland's competition payments for 1999-2000 have

been suspended pending further assessment of the economic viability and ecological sustainability of particular rural water projects.

Two particular matters identified in the Council's second tranche assessment involving local government require further work to meet second tranche NCP obligations. In Queensland, it was not clear at June 1999 that pricing by local government water and wastewater suppliers reflects full cost recovery principles. While all 17 larger councils in Queensland had resolved to commercialise their water businesses or adopt full cost pricing principles from 1 July 1998, information on their progress with this was not available in time for the Council's assessment. For example, there was no substantial information on the valuation of assets for many businesses or on the methodology for determining prices. As a consequence, the Council was unable to conclude that cost recovery objectives are being met across the urban Queensland water industry.

In Tasmania, only one of the 29 local governments has so far fully introduced the two part pricing arrangement for all urban water customers, incorporating a fixed cost for access and a volumetric component based on consumption, as required by the 1994 water reform package. Two others are part of the way towards this objective, having implemented two-part tariffs in urban centres. However, several councils still charge for water and wastewater on the basis of property values, with an excess and/or a minimum charge. Such arrangements are not ideal as property values are not likely to bear any relationship to the cost of service provision and the availability of free water allowances has the potential to distort consumption patterns. It is also very difficult, if not impossible, to meet the COAG obligation to transparently report cross-subsidies where pricing is based on property values.

These matters will be taken up as part of the Council's supplementary assessments of water reform progress.

### **Competitive neutrality**

Competitive neutrality requires that significant government business activities should not enjoy any net competitive advantage over their competitors simply because they are publicly owned. In essence, competitive neutrality principles are aimed at ensuring that significant government owned businesses operating in contestable or potentially contestable markets face the same market disciplines as their private sector competitors.

To achieve fair competition, competitive neutrality policy requires designated businesses to ensure that their prices take account of:

- full attribution of costs incurred in providing the goods and services;
- full Commonwealth, State or Territory taxes or an equivalent;
- debt guarantee fees aimed at offsetting the advantages of government guarantees;
- a commercial rate of return; and
- regulation equivalent to that which private sector competitors would normally face.

The competition agreements also require governments to adopt where possible a corporatisation model for larger businesses classified as Public Trading Enterprises or Public Financial Enterprises. It is probably also worth noting that the agreements do not require compulsory competitive tendering or privatisation. These are policy decisions for governments, and are part of a suite of approaches directed at improving the efficiency of government businesses.

All jurisdictions now have competitive neutrality policy statements and guidelines to assist the implementation of competitive neutrality policy, and report annually on their progress. In addition, each has a mechanism for investigating allegations that relevant government businesses, including local government businesses, are not appropriately applying competitive neutrality principles.

Underpinning competitive neutrality is the need for good information on costs and effective costing systems. The Council accepts that this involves set-up costs for many local governments. However, competitive neutrality policy is generally not the main reason for reforms of costing systems, such as the adoption of accrual accounting. Such reforms pre-date NCP in most jurisdictions, and are part of a world-wide move to a more business-oriented approach. For example, evidence provided to the current Productivity Commission inquiry into the impact of competition policy reforms by the City of Grafton noted that the NSW *Local Government Act 1993*, which pre-dates formal NCP, introduced a number of reforms, including new accounting standards, to increase the transparency and accountability of local government, and to encourage efficiency and effectiveness in service delivery.

There has been considerable variation in jurisdictions' approaches to implementing competitive neutrality particularly in relation to determining what constitutes a significant business. This is seen as appropriate by the Council, which accepts that the diversity of local government in terms of size, geographical location, organisational structure and service responsibilities makes a consistent approach difficult.

There has also been variation in the timing of application of reforms. In some jurisdictions, for example South Australia and Tasmania, the reform program has been delayed pending finalisation of boundary amalgamations. In those states, application of appropriate competitive neutrality reforms is not likely to be completed until 2000. In other States, for example Victoria, competitive neutrality principles are now in place in respect of all government-owned businesses. Queensland is focusing on its largest 17 councils. Application of competitive neutrality reforms in NSW is relatively well advanced. The NSW Government reported that its surveys of local governments showed good progress with competitive neutrality reform with almost 90 per cent of larger businesses having separate internal reporting arrangements and nearly two-thirds of smaller businesses applying full or partial cost attribution in setting prices.

There are several advantages from properly implemented competitive neutrality. These include more efficient pricing practices by public businesses, longer term performance efficiency as a result of operating in a more competitive environment, improved transparency and accountability, and a better basis for assessment by business managers as to whether government should retain responsibility for certain business activities.

While it is possibly still too early to gain a full appreciation of the extent to which these types of benefits are arising at local government level, there are, from the Council's view, some encouraging signs. For example, there is increasing anecdotal evidence coming through that more and more local governments now consider that NCP has fostered a change in culture and that the emphasis on competition has increased productivity.

There is also evidence to suggest that local governments consider that NCP is not the devastating influence that many in local government originally believed it would be. Indeed, it appears that many local governments believe the reverse is true. For example, Tasmania's annual NCP report noted that its local governments are embracing competitive neutrality because of the advantages that it can deliver in increasing the efficiency of council operations. Tasmania pointed to the fact that 18 of 29 councils had decided to apply full cost attribution to all their businesses rather than just those regarded as significant. Even in Queensland, where there has been criticism of NCP from the Premier and Treasurer in the media, the Council is hearing about local governments which are starting to see NCP as a factor in improving the effectiveness of work operations.

The application of competitive neutrality reforms to local government business activities was the only area of first tranche obligations that was the subject of a supplementary assessment for all relevant jurisdictions. From that difficult start, local government reform has gathered acceptance and support, helped by positive measures to assist local government reform by State governments. For example, three jurisdictions – Victoria, Queensland and Western Australia – now provide a proportion of their competition payments to local governments which implement NCP reforms. The shift in the attitudes to, and performance of, local government competitive neutrality reform is exemplified by the fact that no jurisdiction was the subject of a qualified second tranche assessment in this area.

The Council will continue to perform a monitoring role in this area, for example, through scrutinising jurisdictions' annual reports on NCP progress and competitive neutrality complaints reporting. The Council is encouraging governments to work further in this area, including to consider extending competitive neutrality policy to all publicly-owned businesses and to look at arrangements for social objectives such that these can be delivered effectively without unnecessarily compromising the benefits from competition. .

## Summing up

Let me sum all this up.

First, the NCP is a broad-ranging program of economic reform that offers substantial benefits to Australia. Notwithstanding the way it has been misrepresented in public debate recently, NCP is a balanced program of reform, combining economic imperatives with social responsibility – it is not competition for its own sake.

Second, Australia is now two-thirds of the way through the implementation process, and the results so far are positive. Governments have made significant progress in implementing

what is a necessarily sensitive program of reforms. Contrary to the assertions of some of the early skeptics, evidence of substantial benefits is flowing.

But there are a number of reform hot-spots that still need to be addressed, and this will require commitment, leadership and long-term vision from all governments. The Council is adopting a facilitative approach to achieving outcomes, that is, its approach is to work with governments to find solutions to reform difficulties.

For local government, the evidence is that application of NCP, after a difficult start, is progressing satisfactorily. There is certainly some variability in the pace of reform across different jurisdictions and there is perhaps a need for work to continue on better explaining the operation of the public interest test and perhaps in overcoming confusion on matters such as the interplay of social goals and competition objectives. In particular, one message that could be better communicated is that neither NCP generally, nor competitive neutrality in particular, requires the cessation or diminution of community service obligations. The Council is developing a community awareness program which is intended to address this and other matters.

Third, while there are some costs involved such as in setting up business units, there is growing evidence that competitive neutrality is assisting councils in their drive to more efficient and effective service delivery. Water reform has also progressed, but there is still some way to go to achieve the water pricing objectives envisaged by COAG in both urban and rural areas. Getting pricing right for rural water is a requirement for the third and final NCP progress assessment due prior to July 2001.

To summarise, while NCP is not the answer to all Australia's economic woes, it is certainly an important part of it. As the results flowing to date show, it is a program worth taking some fairly serious action to see through to fruition. And as the Council's progress assessments show, there are some significant areas for local government.