



National Competition Council

National Competition Policy:
Some Impacts on
Society and the Economy

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Foreword

While the process of change can sometimes be difficult, the National Competition Policy (NCP) reforms will bring — and are already bringing — important benefits for Australians. This discussion paper considers the effects of NCP reform on a range of social and economic issues, including employment, equity and community services, environmental issues and impacts on rural communities.

The National Competition Council has developed this paper in the context of its role in promoting community understanding and informed debate on NCP. The paper seeks to address some of the recent concerns which have been raised with regard to NCP implementation and clarify some misconceptions. The material in the paper was originally developed in response to two major inquiries launched in 1998 into NCP — the Productivity Commission inquiry into the impacts of NCP on rural Australia; and the Australian Senate inquiry into the socio-economic consequences of NCP reform. The Council believes it is important to promote informed debate on these issues and is therefore releasing the paper for public discussion.

Section 1 of the paper outlines the NCP package and progress to date in implementation.

Section 2 discusses some of the impacts of NCP on social and economic factors, including employment, equity, the provision of community service obligations, and the environment. The Council aims to show that while reform is likely to bring both benefits and costs, the NCP framework takes explicit account of these issues and is designed to introduce reforms which can help society use its resources in more efficient and sustainable ways, creating the conditions to support better living standards, sustainable economic growth and job creation.

Section 3 considers some of the likely impacts of NCP on rural and regional communities. It discusses the implications of local government reform, regulatory reviews into anti-competitive legislation – including legislation governing statutory marketing authorities, water reform and other NCP reforms.

Section 4 of the paper focuses on the public interest safeguards built into the NCP process, and how these safeguards aim to ensure that reform is only applied where it serves the community.

The Council acknowledges throughout the paper that some reforms, while bringing important benefits to the community – such as lower prices and better quality services – may impose costs on particular groups directly exposed to reform. The Council argues that to get the maximum benefit, NCP should be implemented in conjunction with policies designed to manage these distributional effects – for example, education and training programs, tax and social security policies, policies addressing the level of community services, and regional development policies. In this way, the potential benefits of competition reform can be fully reaped, shared equitably and put to the best use.

Executive Summary

The Rationale for Reform

In 1995, Australia's nine governments jointly agreed to implement the National Competition Policy (NCP) reform program.

The package represents a new and important step in pro-competition reform, and builds on a process that was launched with the Trade Practices Act in 1974. The Act established rules to limit the abuse of market power by businesses, promote fair trading and efficient industry practices and to protect consumers.

While the contribution of Trade Practices legislation was significant, governments realised in the mid-1980s that further work was needed. They subsequently gave significant attention to the performance of the Australian economy at the microeconomic level, undertaking numerous reforms:

- some of these introduced greater competition into sectors of the economy, as in the case of domestic airline deregulation;
- others involved more centrally coordinated changes to the structure and operations of particular sectors, as in the case of reforms to higher education; and
- many, such as tariff reductions and the abolition of import quotas, sought to reduce inefficiencies in the traded goods sector.

By the late 1980s and early 1990s, it had become clear that a more balanced and co-ordinated approach to reform across the three spheres of government was required. After a series of inquiries, the Council of Australian Governments (COAG) agreed in April 1995 to implement the National Competition Policy package.

In short, the reforms are to:

- extend the reach of the anti-competitive conduct laws in Part IV of the Trade Practices Act (TPA) to virtually all private and public sector businesses;
- improve the performance of essential infrastructure through implementing reform packages in the electricity, gas, water and road transport industries; and establishing third party “access” arrangements for the services of nationally significant monopoly infrastructure;
- 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, introducing competitive neutrality so that government businesses do not enjoy unfair advantages or disadvantages when competing with private businesses; and considering the use of prices oversight.

Governments also agreed to apply these reforms to local governments in their jurisdiction.

The NCP package puts a national umbrella over a number of reforms which governments were already in the process of developing or implementing. The adoption of a co-ordinated approach to reform on a national basis recognises the growing reality of Australia as a single market, rather than a series of markets delineated by State borders. A national framework also seeks to overcome the inconsistencies that can arise from a more piecemeal approach. In the past, for example, a state-by-state approach in rail led to not only different gauges but also different technical standards and different safety standards. Finally, a national approach allows each State to capitalise on what the others are doing, and obviates the need for each State to individually ‘reinvent the wheel.’

While governments decided to adopt a national focus for competition policy, most of the implementation is happening on an individual government level, with each government in control of how the policies are implemented in their jurisdiction. By agreeing to National Competition Policy they have put a framework around the development of their policies to support keeping the national issues in mind.

While NCP builds on some elements of earlier reforms, it is also different in a number of important ways. In particular, governments turned their attention to a number of sheltered areas of the economy which, for various reasons, had not yet been considered for reform – often by virtue of regulatory or legislative protection or due to the complexity of the task. In addition, many of the NCP reforms touch on complex areas of social and economic regulation.

For these reasons, NCP incorporates a public interest test (see Box A) to assess whether a particular reform is in the interests of the community as a whole – taking account of the interests of each affected group – to assess in an open and objective way whether a particular reform should proceed.

The public interest test covers a wide range of factors, including the environment, employment, social welfare and consumer interests as well as business competitiveness and economic efficiency. The assessment of these factors gives equal weight to economic and social considerations. In this sense, the NCP package seeks to balance economic accountability with social responsibility.

In essence, most NCP reforms are measures designed to reap the benefits that competition, properly harnessed, can bring. The objective is not to pursue competition as an end in itself, but, where appropriate, to inject competition into previously sheltered areas of the economy to boost economic performance and provide benefits to Australian consumers and households.

The strength of competition policy lies in its capacity to improve productivity and economic efficiency. In simple terms, the idea of competition is that two or more producers competing for the same customers are more likely to think of ways to improve efficiency and offer consumers better products, cheaper prices, or both. This may occur, for example, through more efficient work and management practices, greater attention to consumers' demands and more innovation.

By lowering prices, competition can raise the real incomes of consumers. This directly improves people's material living standards and can provide an impetus for economic growth and sustainable job creation. And by lowering input costs for producers, competition can improve the viability of our export and import-competing industries, with important benefits to the nation's external stability.

Box A The NCP Public Interest Test

Under clause 1(3) of the Competition Principles Agreement, governments take into account the following factors when assessing the merits of reforms in relation to competitive neutrality, anti-competitive legislation and the structure of public monopolies:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations 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 businesses; and
- the efficient allocation of resources.

The list is open-ended, meaning that any other relevant matter should also be considered when assessing the case for a competition reform.

Effects of Reform on Society and the Economy

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

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

That said, many concerns commonly ‘blamed’ on NCP – such as privatisation, compulsory competitive tendering and cuts in public services – are misguided. In fact, NCP contains no requirement for privatisation or compulsory competitive tendering, and does not seek to mandate the level of provision of community services.

Instead, the focus of NCP is to promote the best value for money in delivering goods and services which the community values. But NCP does not mandate which products should be delivered. Nor does it seek to judge whether particular products are best delivered by the private or public sector.

However, NCP will *affect* many socio-economic issues, including employment, the environment and the provision of government services. While community perceptions appear to be that these effects are usually negative, section 2 of this paper argues that the reality is more complex.

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

For example, the water reforms – perhaps the most far reaching in the NCP framework – embody a comprehensive package of measures aimed at reaping benefits from economic, social and environmental perspectives. The reforms aim to promote more efficient use of water through pricing reform and the introduction of tradeable allocations, allowing water to be used in ways that the community places highest value on. At the same time, reforms to pricing and investment guidelines will encourage better conservation and greater accountability in environmentally-sensitive matters such as dam construction. The establishment of appropriate drinking water quality standards, water quality monitoring and catchment management policies are other important elements of the package. The recent crises over water quality in Sydney and Adelaide have highlighted the importance of these issues.

Similarly, the recent Victorian gas crisis illustrated some of the socio-economic benefits of the NCP gas reform program. The suspension of Victorian gas supplies following the Longford disaster in September 1998 would have left Victoria without gas for emergency services in the absence of NCP reform. But implementation of the National Gas Pipelines Access Code, a centrepiece of NCP gas reform, was a critical factor underpinning the construction of a \$50 million 'interlink' pipeline between New South Wales and Victoria, which allowed emergency supplies of gas to flow into Victoria from interstate throughout the crisis. Although interstate trade in gas is still at an early stage, the interlink pipeline is indicative of the kind of benefits which lie ahead.

Box B Some early outcomes from competition reform¹

- Following the introduction of competition, electricity bills fell by about 23 to 30 percent on average, for those NSW and Victorian businesses covered by the national competitive market; while wholesale prices in Queensland fell by around 23 percent after its internal competitive electricity market commenced.
- Gas prices for major industrial users fell 50 percent after deregulation of the Pilbara market in 1995, while gas distribution tariffs are set to fall 60 percent by the year 2000 in NSW.
- Rail freight rates in Western Australia have fallen by 42 percent in real terms since 1991-92, while rail freight rates for the Perth-Melbourne route fell 40 percent, and service quality and transit times improved, following the introduction of competition in 1995.
- Conveyancing fees in NSW fell 17 percent between 1994 and 1996, after the abolition of the legal profession's monopoly and the removal of price scheduling and advertising restrictions, leading to an annual saving to consumers of at least \$86 million.
- Prices for the outputs of government trading enterprises fell substantially between 1991-92 and 1995-96, and payments to governments doubled, due partly to competition reforms. More recent evidence shows that these trends are continuing. In the five years to 1996-97, the sharpest price reductions occurred in electricity (24 percent), port services (23 percent), telecommunications (23 percent) and air traffic services (40 percent).
- In Queensland, ten of the seventeen largest local councils have implemented two part tariffs for water, resulting in an average saving in water usage of 20 percent in the first year.
- Following a review of business licensing in NSW that found significant duplication and overlap, some 72 licenses have been repealed and more are being scrutinised. Among other changes, 44 categories have been collapsed into just three.

¹ Adapted from the Council's 1997-98 Annual Report. The source material for this information is provided in the Annual Report.

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

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

Given that reform can impose costs on some groups, it is important that the application of the NCP public interest test be rigorous, independent, and incorporate the interests of the community at large.

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

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

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

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

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

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

It should also be borne in mind that failure to introduce reform can impose its own costs on the community. For example, prior to introducing national reforms in electricity, the industry was characterised by overcapitalisation in power stations, poor efficiency and high energy charges which damaged the international competitiveness of Australian industry. Similarly, uncompetitive structures in the water industry have contributed to inefficient approaches to infrastructure, poor conservation and degradation of the nation's rivers. Finally, in gas, the potential risks of monopoly structures in the upstream gas sector were graphically illustrated by Victoria's Longford gas crisis in September 1998.

Section 2 of this paper also considers the likely effects of reform on a range of specific socio-economic outcomes.

Employment

The NCP reforms will affect employment in a range of ways – both positive and negative.

Jobs will be lost in some of the industries directly exposed to reform – in the short term at least – as firms experience greater pressures to lift productivity and reduce costs. This has been observed, for example, in regard to some electricity and telecommunications businesses.

However, there are likely to be employment gains, particularly in other industries. As indicated in Box B, competition brings lower prices for many products. This increases household spending power, encouraging firms to increase production and employ more workers. Lower prices also improve the cost competitiveness of thousands of Australian businesses which rely on services like electricity and legal advice. Once again, this creates an incentive for higher levels of production and employment.

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

To get the maximum benefit in terms of jobs, NCP should be implemented in conjunction with policies designed to manage these distributional effects – for example, education and training programs to enhance the vocational skills base of unemployed workers and young people about to enter the labour force (section 2.3).

Equity Issues

While NCP is not specifically aimed at promoting equity, its implementation has a range of effects on this issue. For example, NCP exposes previously sheltered areas of the economy to competition, creating the risk of lower incomes, business failure or unemployment for some of the people directly exposed to reform.

On the other hand, NCP reform often involves removing anti-competitive arrangements that traditionally conferred unfair privileges on sheltered groups – often high income earners – which the rest of the community do not enjoy.

In addition, many NCP measures will encourage cheaper prices of affected services, helping to reduce the gap between rich and poor households. For example, the

energy reforms will cut consumers' power bills. As low-income households spend a larger proportion of their incomes on energy than households on high incomes, these reforms should improve equity (section 2.4).

Community Service Obligations

NCP recognises the importance placed by society on providing community service obligations (CSOs). At the same time, it recognises the need to improve mechanisms for defining, funding and delivering CSOs. This is consistent with the emphasis all governments place on improving the efficient and effective delivery of CSOs, including improved reporting and monitoring procedures.

But governments are free to subsidise important community services for well-defined target groups – such as aged pensioners – under the NCP reforms. In fact, competition reform can help governments deliver services more cost-effectively, leaving them with more money to provide important CSOs (section 2.5).

The Environment

The NCP framework requires governments to take account of environmental impacts of reform as part of the public interest assessment process.

Environmental considerations also play a role in specific reforms. For example, a key aim of the *water* reforms is for people and businesses to pay according to how much water they use – to encourage better conservation. The water reforms also recognise the environment as a user of water, with a right to a share of water allocations, in the same way as consumers and industry. There are also measures to maintain healthy river systems and groundwater basins in the future, and new rules for the construction of dams to take better account of environmental impacts.

The energy reforms also have significant implications for the environment. For example, the creation of a national *electricity* market allows suppliers to sell 'green energy' into the market and makes it easier for consumers to buy energy from renewable sources (section 2.6).

Adjustment Assistance

A public interest assessment sometimes finds that a particular reform should proceed because it delivers important community benefits – even though it may impose costs on people in particular regions, industries or communities directly exposed to reform. The Council argues in section 2.2 of this paper that these costs should be addressed by governments. While various measures, such as social security payments and subsidised training schemes, already exist for people who lose their jobs as part of normal economic activity, governments may need to consider whether *additional* assistance should be offered to those directly affected by particular reforms such as NCP.

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

One form of assistance adopted for most of the NCP reforms – such as the energy, water and legislation review programs – is to *phase* in reform. On the other hand, *specifically targeted assistance* may be warranted if the people affected have few alternative choices available – for example, if reform causes significant unemployment in a remote area.

The issue of pro-active adjustment assistance has been acknowledged in relation to a number of NCP reforms, including the legislation review program. For example, the Industry Commission's review of the *Customs Tariff Act 1995 – Textiles Clothing and Footwear Arrangements* made several recommendations on

adjustment assistance, including changed eligibility criteria for employment assistance services and additional funding for these activities.

The water reforms are another area of the NCP package which specifically recognise adjustment issues. For example, the NSW Government recently announced a \$33 million structural adjustment package to assist irrigation farmers to adjust to the new water management arrangements. The package targets farm business planning, irrigation skills training, financial assistance for water-efficient techniques and technologies, and re-establishment assistance, where required.

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

Impacts on Urban and Rural and Regional Communities

There is little evidence to date on the relative effects of NCP reform on urban and rural and regional Australia. Monitoring these relative impacts is particularly difficult at present, given that NCP implementation is still in its early stages. The Productivity Commission is currently investigating this issue, and their review into the *Impact of Competition Policy Reforms on Rural and Regional Australia* is expected to provide important evidence on this matter.

The issue of competition policy and its effects on rural and regional communities has been the subject of considerable anxiety in the community. The concerns include fears that competition policy will cause a loss of services to the bush, that farmers will not be able to market their produce through co-operatives, that the prices of farm inputs like water will rise, that job opportunities will dry up and that any benefits from competition will go mainly to city people and big business.

Some of these concerns do reflect uncertainty as to the potential impact of NCP in such areas as the reform of statutory marketing arrangements and water reform. But other concerns, such as the erosion of rural services, are more closely linked to changes in the Australian economy which have been taking place over recent decades, causing much social dislocation. Much of this hardship stems from declining business opportunities in rural communities caused by falling world prices for agricultural commodities, improvements in farm productivity, and a population drift towards larger regional centres and the cities. Closures of banks, for instance, are commercial decisions which reflect dwindling commerce in many rural and remote areas, and have little or nothing to do with NCP.

But clearly, a number of areas of NCP are likely to have particular impacts on rural and regional communities. Many of the reforms offer substantial benefits to these communities – for example, the new water trading arrangements and the impacts of reform on reducing rail freight charges, energy costs and prices of imported farm equipment and fertilisers.

Sometimes, however, due to differences in scale between business activities in rural and urban areas, the benefits of reform may weigh more strongly in favour of urban communities with access to markets with vigorous competition. And in some cases, particular regions or industries in rural areas may be directly exposed to the reform process, creating the potential for a considerable burden of costs.

At the same time, the reform framework is designed to take account of these costs. The NCP public interest safeguards allow the costs and benefits of reform – including the impacts on individuals, regions and particular industries – to be weighed openly and rigorously to ensure that reform is in the interests of the community as a whole. This can sometimes require a delicate balancing of interests, but the reform

framework is designed to ensure that the interests of all parties are considered, with any trade-offs made explicit. Where reform is found to be justified, but the distribution of costs and benefits weighs unfairly on a particular region or community, there is a case for governments to consider compensatory measures – for example, through policies on regional development and the provision of well-targeted community service obligations.

Section 3 of this paper examines five key interfaces between NCP and rural and regional communities. While reform can bring about certain costs for rural and regional communities, there are also significant potential benefits.

Local Government Reform

Concerns have been raised that applying competitive neutrality to significant *local government* businesses may impact negatively on the skills base and employment opportunities in rural and remote areas – especially where the reforms are linked to competitive tendering. But as noted in section 3.2, the public interest test allows these potential costs to be carefully considered against the potential benefits of reform. Properly applied, competitive neutrality reform offers scope for cost savings in service delivery, rates relief and a greater pool of funds for investment and other local priorities. This can assist local government in reconciling the community's expectations of improvements in welfare, recreation and community services in times of constrained revenue raising capacity.

Reviewing Statutory Marketing Arrangements

The review of Commonwealth, State and Territory legislation and regulation governing *statutory marketing arrangements* (SMAs) has raised concerns that

reform offers benefits to urban dwellers – through cheaper farmgoods – while imposing significant costs on the rural farming communities exposed to reform. But as section 3.3 notes, 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.

Reviewing other Anti-Competitive Legislation

Section 3.4 acknowledges concerns that reforming legislation governing the supply of services such as petrol can sometimes promote an expansion of services in larger regional centres at the expense of small businesses in outlying rural and remote communities – with adverse implications for social cohesion in these communities.

These are legitimate concerns that should be taken into account in cost-benefit assessments of whether reform is in the public interest. But as section 3.4 argues, NCP is likely to offer countervailing benefits – for example, while the provision of services like petrol may become more centralised in regional centres, there is also the likelihood that rural communities will benefit from cheaper prices for these services. In addition, there is evidence that regulatory reform of such areas as legal services and optometry has the potential to improve access in rural areas – for example, by removing overly rigid regulatory barriers to the supply of these services.

Water Reform

Concerns have been raised that the water reforms will raise the price of water – especially for irrigation – imposing pain on farming communities. While acknowledging these adjustment costs, section 3.5 argues that failure to implement

the water reforms would involve much higher costs for rural communities – continued degradation of our rivers coupled with a deterioration in water quality to the point where the demand for water cannot be met, rising salinity in groundwater and soils in farming areas, depletion of fish stocks and so on.

The reform measures aim to safeguard the sustainability of water resources, provide for proper maintenance of water infrastructure, and through water trading, encourage higher value-added cropping and sustainable wealth generation in rural communities. At the same time, governments should consider the need for adjustment assistance to help irrigation farmers adjust to the changes.

Other NCP Reforms

Section 3.6 notes other NCP reforms which are delivering, or will deliver cheaper prices in energy, rail freight, imported farm equipment, vehicles, and fertilisers to rural and regional communities.

The Public Interest Test

Public interest issues arise in a number of contexts under NCP reform, as set out in section 4 of this paper. In particular, the merits of applying three key reforms – competitive neutrality, the structural reform of public monopolies, and the reform of anti-competitive legislation – should be determined on a case by case basis by applying a public interest test.

The public interest test was written into the NCP framework to allow *all* relevant factors to be considered when deciding whether restrictions on competition are

warranted. The test requires consideration of an array of public interest matters, including the environment, employment, social welfare and consumer interests as well as business competitiveness and economic efficiency (see Box A).

The NCP agreements give social and environmental values no more or less weight than financial considerations in determining where the public interest lies. In other words, the presumption is that all public interest considerations intrinsically carry equal weight.

For example, a review into the merits of a statutory marketing arrangement should consider such matters as the impacts of barriers to competition on the level and stability of farmers' incomes, the welfare of Australian consumers, implications for the value of Australian exports, environmental impacts, administrative and regulatory costs, effects on regional development and employment, economies of scale in transport and marketing, agricultural productivity and implications for value-adding industries.

A challenge for review bodies and for governments is to focus on outcomes that benefit the *community as a whole*, rather than providing special treatment for certain groups at the expense of others. Most anti-competitive restrictions benefit someone. But where this imposes costs on others (such as forcing consumers to pay higher prices than would otherwise be necessary), it is important that each side of the argument be weighed in an objective and transparent manner.

At the same time, it is important that the impacts of reform on the individuals, regions and industries directly exposed to reform are taken into account. It is also important that any trade-offs between the interests of different groups are made explicit so that governments can objectively consider whether compensatory measures are warranted.

For these reasons, the Council has consistently stressed the importance of independent, transparent and rigorous *processes* by governments in considering public interest matters. This is essential to maintain community confidence that public interest considerations have been objectively examined.

Once public interest considerations have been rigorously assessed in an independent and transparent forum, the best course of action – whether to implement reform or not to do so – will be apparent, and the public interest would be best served by governments adopting the recommendations accordingly.

A number of State and Territory reviews have recommended that restrictions on competition be retained in the community interest. Where these reviews use transparent, independent and objective processes, the Council has accepted these outcomes as satisfying the intent of the NCP agreements.

The degree of rigour required in a public interest assessment depends to some extent on the circumstances. For example, the Council does not seek to promote excessively bureaucratic processes for relatively minor matters.

Conversely, it would not be appropriate to *exempt* an area from reform without first conducting a rigorous cost-benefit analysis – to do so would invite claims that reform has been suppressed to satisfy vested interests. Similarly, where the net public benefit is unclear, or where there are claims that reform is against the public interest, decisions should be based on an objective assessment of the facts.

In general, the process followed should reflect the significance and complexity of the particular reform or issue (taking into account such matters as the range of affected stakeholders and community sensitivity). As a minimum, however, interested parties should be given the opportunity to participate and should have confidence that their views will be taken into account and given due consideration.

The process for *measuring* costs and benefits requires judgement. The House of Representatives Standing Committee on Financial Institutions and Public Administration (Hawker Committee) cited a range of approaches currently in use, in its 1997 Report, *Cultivating Competition*. The Committee accepted the use of both quantitative and qualitative assessments where appropriate. It also noted the need for greater guidance to local governments in the practicalities of conducting public benefit assessments. The Council notes that this problem is now being addressed in Queensland with comprehensive training programs, and encourages the wider use of this approach.

In considering community benefits and costs, it is important that both short-term and longer-term factors are taken into account. It is often the case that the costs of reform – such as employment losses in firms directly exposed to reform – are short-term, upfront and concentrated, whereas benefits – such as cheaper prices to consumers and flow-on benefits of new jobs elsewhere in the economy – are often longer term and widely dispersed throughout the community. For this reason, a “first glance” consideration may only provide part of the overall picture.

1. The NCP Package and Progress to Date

1.1 The approach to National Competition Policy

The Commonwealth and all State and Territory governments adopted the NCP package in 1995. Because of the size of the package, implementation has been phased over several years. The National Competition Council plays a number of roles in the reform program, including assessing each government's progress in meeting its reform commitments at three stages of implementation: in July 1997, 1999 and 2001.

The Council has just finalised its first tranche assessments, and the progress to date has been positive. Most of the early activity focused on getting the policy agendas right, but a number of reforms have also been implemented, with some promising early results.

At the same time, recent public debate has revealed widespread confusion about competition policy and how it ties in with other government policies. For example, it has been suggested that the NCP agreements require certain policy actions such as repealing all anti-competitive legislation or privatising government businesses. Conversely, NCP is sometimes thought to preclude certain policy actions by governments, such as subsidising community services. More generally, there exists a concern that NCP is a form of 'economic rationalism' which focuses on money, markets and materialism with no regard for equity, the environment or the social fabric.

These concerns stem in part from limited awareness of the public interest safeguards built into the NCP processes. For example, when reviewing anti-competitive

legislation, governments must consider the effects of reform options on an array of public interest matters. These include the environment, employment, social welfare and consumer interests as well as business competitiveness and economic efficiency. These public interest matters must also be considered when assessing whether to apply competitive neutrality to particular government businesses and when reforming the structure of public monopolies (see Appendix 1).

The concerns about competition policy also stem from limited awareness of what the NCP program actually requires of governments. To clarify some of the most common misconceptions:

- NCP does not require the removal of all anti-competitive regulation, but ties reform directly to public interest safeguards (see section 1.5).
- NCP does not require the privatisation of any public entity (see section 1.6).
- NCP does not require reductions in government spending on important community services (see section 2.5).
- NCP is consistent with providing appropriate adjustment assistance when a reform measure adversely affects a particular section of the community (see section 2.2).
- Various NCP processes integrate economic and environmental considerations (see section 2.6).

1.2 The NCP reform package

The NCP reform program is set out in three intergovernmental agreements signed in April 1995 (see Box 1), operating in conjunction with the *Competition Policy Reform Act 1995*.

Box 1 The NCP Agreements

The Commonwealth and State and Territory Governments signed three agreements in April 1995 to implement the National Competition Policy reform package.

1. The ***Conduct Code Agreement***, operating in conjunction with the *Competition Policy Reform Act 1995*, sets out processes for amending the competition laws of the Commonwealth, States and Territories to extend the coverage of Part IV of the *Trade Practices Act 1974* to all businesses in Australia, irrespective of their ownership.
2. The ***Competition Principles Agreement*** (CPA) establishes reform principles in relation to access to essential infrastructure facilities; prices oversight of government businesses; structural reform of public monopolies; fair competition between government businesses and private sector businesses; reviewing the merits of anti-competitive legislation and regulation; and the application of competition principles to local government. Clause 1(3) of the CPA also sets out a public interest test to enable governments to assess the merits of proceeding with particular reforms.
3. The ***Agreement to Implement the National Competition Policy and Related Reforms*** incorporates COAG reform agendas for the electricity, gas, water and road transport industries into the NCP framework. The Agreement also sets out conditions for financial transfers from the Commonwealth to those States and Territories which implement the NCP reforms, and the timetable for implementing reform.

The Council has published a compendium of the NCP agreements (NCC 1998b), which is available on the Council's website: www.ncc.gov.au

In summary, the NCP reforms agreed by governments in 1995 were to:

- extend the reach of the anti-competitive conduct laws in Part IV of the Trade Practices Act (TPA) to virtually all private and public sector businesses;
- improve the performance of essential infrastructure through implementing reform packages in the electricity, gas, water and road transport industries; and establishing third party “access” arrangements for the services of nationally significant monopoly infrastructure;
- 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, introducing competitive neutrality so that government businesses do not enjoy unfair advantages when competing with private businesses; and considering the use of prices oversight.

Governments also agreed to apply these reforms to local governments in their jurisdiction.

Sections 1.3 – 1.6 of this paper examine the reforms in more detail.

The Council’s Role

The National Competition Council was created in 1995 as an advisory body to governments on NCP implementation. While the Council is independent of the executive arm of any government, its work program is set by agreement of a majority of Australian governments.

In short, the Council has three key roles.

1. Assessment

The Council is required to assess each State and Territory government's progress in implementing NCP reform for the purpose of \$16 billion in competition payments from the Commonwealth over the period to 2005-06.

2. Functions related to specific NCP reforms

The Council plays a number of roles in relation to specific NCP reforms. To date, these roles relate principally to two areas:

- third party access to infrastructure. For example, the Council makes recommendations to governments on the effectiveness of State and Territory access regimes and on applications to declare significant monopoly infrastructure for third party access under the *Trade Practices Act*; and
- the review of anti-competitive legislation and regulation. For example, the Council recently conducted an inquiry into the *Australian Postal Corporation Act 1989*. The review was referred to the Council by the Commonwealth with the agreement of a majority of States and Territories.

3. Improving community understanding of NCP

The Council supports governments in explaining to the community the important relationships between competition reform, other aspects of government policy, and community objectives such as economic growth, full employment and social and environmental goals. The Council sees this role as particularly important, given that many of the reforms are complex and involve change – which can create conditions of uncertainty in the community. Three recent Parliamentary inquiries into the Council and the NCP program have emphasised the importance of community consultation and communication.¹

¹ House of Representatives Standing Committee on Financial Institutions and Public Administration (Hawker Committee) 1997, *Cultivating Competition: Inquiry into Aspects of the National Competition Policy Reform Package*, June; Joint Committee of Public Accounts and Audit 1998, *General and Specific Purpose Payments to the States*, Report no. 362, June; House of Representatives Standing Committee on Financial Institutions and Public Administration 1998, *Review of the National Competition Council Annual Report 1996-97*, June.

This discussion paper arises in the context of the Council's role in promoting community understanding and informed debate on NCP.

1.3 Extended coverage of Trade Practices Act

The scope of Part IV of the TPA has been expanded to cover virtually all private and public sector business activities.

Broadly speaking, Part IV prohibits a range of anti-competitive trade practices including:

- anti-competitive agreements;
- misuse of market power;
- exclusive dealing;
- resale price maintenance; and
- mergers which have the effect, or likely effect, of substantially lessening competition.

Constitutional limitations had previously prevented application of these provisions to unincorporated businesses, such as legal partnerships, operating solely in one State. Further, it was unclear whether the TPA covered State and Territory government businesses.

To rectify this, governments have enacted a modified version of Part IV, called the *Competition Code*, in each of their jurisdictions. All jurisdictions enacted this legislation in 1996.

1.4 Improving the performance of essential infrastructure

Services such as energy supply, transportation, communications and water supply play a vital role in the Australian economy. They are major business inputs, essential services for consumers, and the industries that supply these services are major resource users in their own right.

NCP takes a two-pronged approach to improving these essential service industries:

- specific National agreements for reforms in the electricity, gas, water and road transport sectors; and
- general 'access' regimes for all infrastructure services.

Energy

The NCP energy reforms are the furthest advanced. They seek to improve the efficiency of the electricity and gas industries, open these markets up to new businesses, and cut costs to energy users.

The *electricity* reforms are among the most ambitious in the NCP package, and aim to develop a national electricity market ultimately covering NSW, Victoria, Queensland, South Australia, Tasmania and the ACT.

A competitive market is currently evolving, with NSW, Victoria, South Australia and the ACT commencing interstate trade from May 1997. Queensland has introduced a parallel competitive market in preparation for interconnecting its power grid with NSW – expected by 2001 – and Tasmania has also announced its intention to interconnect. As part of the reform package, a National Electricity Code has been developed, including access arrangements covering the natural

monopoly transmission and distribution power grid. The ACCC granted approval of the code in October 1998, and the full operation of the national market rules commenced in December 1998 in all south-eastern mainland jurisdictions.

The reforms are creating a competitive wholesale market, in which generators bid for the right to supply the market, and customers compete for the right to buy. This has already occurred in the south-eastern mainland jurisdictions on an individual State basis. However, the introduction of interstate trade is creating more depth than is possible in the individual State markets – where the number of generators and major buyers is relatively small. As Box 2 indicates, the introduction of competition has already produced some significant price reductions, with indications that service standards are being maintained or improved. Given the importance of electricity in the cost structures of many businesses, the reforms are boosting the international competitiveness of Australian export and import-competing industries.

Interstate trade will also help address issues of deficient generating capacity in some States, and excess capacity in others – reducing the risk of overcapitalisation in new power stations.

Similar measures have been implemented in relation to *gas*. The central reform is a National Gas Pipelines Access Code developed by all jurisdictions, and implemented in most States and Territories by 30 June 1998.² The National Code creates a legally enforceable right for people to gain access to the services of natural gas pipelines at fair and reasonable prices. This is an important breakthrough in creating more competitive gas markets as it gives customers greater scope to negotiate with a range of gas suppliers, knowing that it is possible to access a pipeline to carry the gas to the required destination. The added competition is pushing down prices of both gas and gas haulage services (see Box 2).

Although it is still early days, these developments are helping to expand the market for natural gas, fuelling the development of new pipeline proposals to link key gas

² The exceptions are Western Australia, which expected to pass implementation legislation by 30 September 1998, and Tasmania, which does not have a natural gas industry at present.

Box 2 Some recent outcomes of energy reform

- A survey (ACM 1998) of businesses able to select their own electricity supplier under the national market found an average reduction in electricity bills of 30.6 percent in NSW and 23.2 percent in Victoria. While some of these gains were partly reversed late in 1998, those States most exposed to competition remained substantially cheaper electricity suppliers than other jurisdictions (*Australian Financial Review*, Sept 29, 98).
- A similar study of major businesses (Deloitte 1998) found that 88 percent had achieved savings of more than 20 percent.
- The Victorian Government reported in June 1997 that from November 1992 to May 1997, a typical Victorian household gained a 9.2 percent real reduction in the cost of electricity; a typical household using electric hot water now spends \$66 less than it would have without the competitive industry. The Government also reported a 47 percent reduction in residential disconnections in the second half of 1996 compared with the same period in 1995.
- Victoria's Office of Regulator General (ORG) reported in 1997 that downtime from blackouts had fallen 50% since 1989-90, meaning that reliability of supply had risen by 50 percent. In 1998, the ORG reported that since privatisation, Victoria's electricity suppliers have generally improved or maintained their services to customers. While results varied between the five distributors, total downtime fell by 9 percent compared to the previous year, and affordability of supply and customer services had improved since 1996.
- After the commencement of the competitive wholesale market in Queensland in March 1998, wholesale electricity prices fell by around 23 percent (QERU 1998).

Box 2 ...cont

- In Western Australia, gas prices fell 50 percent for major industrial users after deregulation of the Pilbara market in 1995 (Barnett 1996); while transport tariffs on the pivotal Dampier-Bunbury pipeline will fall by around 26 percent between 1997 and 2000 under a transitional price path (Moran 1997, Farrant 1998).
- Gas distribution prices in New South Wales are to fall by up to 60 percent in real terms by 2000 under an AGL access undertaking accepted by the New South Wales regulator in 1997 (IPART 1997).

basins with major markets. Two of these proposals – the AGL-Chevron pipeline from Papua New Guinea to Queensland, and the Westcoast pipeline along the south-eastern seaboard – are now well advanced, with significant potential benefits for national and regional economic development.

Similarly, a \$50 million ‘interlink’ pipeline between New South Wales and Victoria was opened in 1998, allowing natural gas trades between the two states for the first time. The National Code was an important factor underlining the viability of the new pipeline, as it created an enforceable right for the pipeline owners and gas producers to access the distribution networks in major markets like Melbourne and Sydney. The pipeline played a vital role in September 1998, when Victorian gas supplies were suspended by the Longford disaster. The interlink allowed emergency supplies of gas to flow into Victoria from interstate throughout the crisis.

Governments are continuing their work with energy reform to ensure that the prospective benefits are reaped Australia-wide. For example:

- electricity price reductions should spread as competitive market arrangements expand to cover small business and households, and as more States join the national market; and

- with significant reform now accomplished or in train in relation to gas transportation, attention is now being given to the 'upstream' sector where there is scope for greater competition between and within gas basins. This can be a difficult issue due to the nature of long-term contracts between suppliers and major customers in many States. The Longford gas disaster illustrates the potential risks stemming from major gas markets relying exclusively on a single supplier. An intergovernmental working group examined 'upstream' issues in 1998 and was due to report to COAG and ANZMEC on reform options in December.

Water

Many of Australia's river systems are in crisis. Outbreaks of blue-green algae, excessive diversions of natural flows, increasing pollution and rising salinity are all taking their toll. Native fish populations, and wetlands and streams have been affected. There are salinity problems in many farming areas such as those in the Murray-Darling Basin,³ and water quality and reliability is at risk in some catchments. At the same time, water has been priced below cost, encouraging overconsumption and discouraging conservation. As the Australian Financial Review recently noted:

Australians are the world's second most voracious and wasteful consumers of water, despite living on the driest inhabited continent... Australians drink less than 5 per cent of the water they use, and nearly 30 per cent (of urban water) is used watering the lawn around the great Australian dream home. (*Australian Financial Review*, August 10 1998).

The NCP water reforms are a direct response to the need to halt the degradation of this natural resource and seek to address both the economic viability and ecological

³ The Murray-Darling Basin covers four states and one territory (Queensland, NSW, Victoria, South Australia and the ACT), supports over 20 cities, has a population of 3 million, and is Australia's most important agricultural region. The Basin produces annual agricultural output exceeding \$10 billion or one-third of national rural output.

sustainability of the nation's water supply through the following measures:

- pricing reform based on principles of consumption-based pricing, full-cost recovery, and removal of cross-subsidies, with remaining subsidies made transparent – encouraging people to use water more wisely by basing their consumption decisions on prices reflecting the actual value of the water they use;
- water allocations or entitlements, including allocations for the environment, coupled with trading in water entitlements – allowing water to flow to those activities bringing maximum benefit to the community;
- improved water quality monitoring and catchment management policies and a renewed focus on landcare practices to protect rivers with high environmental value;
- future investment in dams and other water infrastructure being undertaken only after appraisal indicates it is economically viable and ecologically sustainable – addressing the need for cost-efficient investment with due regard to environmental concerns; and
- structural separation of the roles of service provision from water resource management, standard setting and regulatory enforcement.

The Council believes that the water reforms are among the most significant in the NCP package. Implementation is being phased in over five to seven years, to give people forward notice and time to adjust, and because of the sheer size and complexity of the package.

So far, the scope and pace of reform differs across Australia. Each government is taking a different approach to water reform, and rates of progress vary. New South Wales and Victoria are the furthest advanced. Other governments have implemented fewer reforms, or are still in the process of developing their approach to some areas. Some important recent reforms include:

- the NSW Government introduced water reforms in 1997 and 1998 that target explicit sharing of water between the environment and consumption. The

Government has identified a number of 'stressed rivers' and, for seven key rivers, announced that up to 10 percent of annual diversions would be reserved for the environment. Targets have also been set for 1998-99 to increase native fish breeding and migration, improve bird breeding in wetland areas, suppress algal blooms and provide greater long-term certainty of volumes and water quality for all water users;

- several States have begun the process of bringing water pricing into closer alignment with levels of consumption and the cost of supply. In Queensland, for example, consumers reduced their water use by around 20 per cent in the first year of the new pricing system, bringing significant environmental benefits. Pricing impacts will vary from State to State, depending on the extent of existing subsidies. In Victoria, where reform was already relatively advanced, the price of domestic water fell by 18 per cent in 1998. In NSW, however, prices for bulk water are set to rise over the next two years; and
- on 1 January 1998, a trial interstate water trading project began in the Mallee Region in NSW, Victoria and South Australia. The first permanent interstate trade in water occurred in September 1998. Interstate trading allows water to flow to areas where value-adding is highest, bringing benefits to rural communities (see section 3.5).

Road transport

The NCP program also covers road transport. There is already significant competition in the road transport industry itself, so the reforms are focussing on matters such as national licensing requirements for heavy vehicle operators, road pricing and vehicle standards.

However, progress to date has been slower than initially expected. National implementation has been hampered by difficulties with the 'template legislation' approach that was originally proposed, as well as by the lack of a concrete timetable for reform.

Access

The NCP package includes an ‘access’ regime allowing businesses to use essential infrastructure services at a fair and reasonable price, where this promotes competition in a related market. For example, a transport company may be able to gain access to a rail network and operate its own trains, in competition with the existing train operator.

The Commonwealth, States and Territories have already established access regimes for infrastructure services such as telecommunications networks, gas pipelines and shipping channels, and they are developing others. But for nationally significant infrastructure services not already covered by an access regime, the NCP package creates a generic national regime set out in Part IIIA of the Trade Practices Act.

The Council has a role in recommending the approval of State and Territory access regimes and handling applications from businesses that want to obtain access rights under the national regime. To date, most use of the national arrangements has been in relation to rail transport – the lack until recently of a national approach to rail reform has forced many freight businesses seeking to compete with existing government train operators to use the access provisions. Access to rail infrastructure will encourage greater competition between freight operators and cheaper rail freight charges, bringing significant benefits to rural communities in particular.

The Council has recommended that several services be ‘declared’ for access, although most of these matters have been appealed to the Australian Competition Tribunal. The Tribunal is yet to hand down a decision on a substantive matter.

While delays of this nature are part and parcel of testing a new law, in several cases the threat of declaration appears to have forced the pace of change. For example, following its lodgement of a declaration application with the Council, Futuris was able to negotiate access to the AlintaGas high pressure gas distribution network in Western Australia. Similar outcomes have occurred following the lodgement of appeals.

1.5 Reviewing the merits of anti-competitive legislation

There are many pieces of legislation in Australia which contain provisions that restrict competition. They constrain peoples' choices of what they can buy and who they can buy from.

Often regulations perform a necessary function, such as addressing consumer protection, environmental, and public health and safety issues. But many restrictions have been around for years and often the circumstances of the industry have changed without any independent assessment as to whether the restrictions still serve any useful purpose.

As part of the NCP, governments have agreed to review and – where the restrictions are not in the public interest – reform their laws that constrain businesses from competing for customers. The program covers almost 2000 pieces of legislation. It also entails mechanisms to vet new or amended regulations to ensure that they do not unduly restrict competition.

The guiding principle for reviews is that legislation should not restrict competition *unless* it confers an overall community benefit and its objectives cannot be obtained in other ways.

There has been considerable confusion about this area of NCP in the community. It should be emphasised that NCP does *not* require removing all restrictions on competition. Instead, governments are reviewing laws that prevent businesses from competing freely to check whether they benefit the community as a whole rather than simply advantaging one group at the expense of others. If an independent review finds that a particular law does benefit the community as a whole, and there is no better way to do so, the law should be retained under NCP principles.

The NCP agreements list a range of public interest matters that government have agreed to take into account in assessing the benefits and costs of a restriction,

including the environment, employment, regional effects, consumer interests and the competitiveness of business (see Appendix 1).

Anti-competitive legislation can serve the public interest by, for example, setting appropriate accreditation standards for professional services. But in many cases, allowing more competition can protect consumers from unfair pricing by producers with monopoly power. This is because two or more producers competing for the same customers are more likely to find ways of offering consumers better products, cheaper prices, or both. For instance, after people other than lawyers were allowed to offer conveyancing services in NSW, conveyancing fees fell by 17%.

While the early work in this area of NCP reform revolved around developing review schedules and processes, the pace of undertaking reviews has picked up in the last year. The Council estimates that, as at July 1998, the States and Territories had completed more than 300 reviews with a similar number underway. Some key review areas in 1997-98 included agricultural marketing arrangements, regulation of the professions, restrictions on shop trading hours and liquor licensing and gambling legislation.

However, governments are yet to implement decisions in response to the recommendations of many of the recent reviews, and in cases where governments have implemented changes, there generally has been insufficient time to gauge their precise effects. Box 3 provides an indication of the type of outcomes which can be expected.

Box 3 Some outcomes of early legislation reviews

- Following a review of 250 business licenses in New South Wales that revealed significant overlap and unnecessary regulation, 72 licenses have been abolished (as at 1 January 1998), with a further 13 nominated for possible repeal. In one case, 44 categories have been collapsed into just three.
- In South Australia, a review found that while aspects of the Water Resources Act are restrictive, they generate net benefits by mitigating the risk of environmental degradation and disputes over water usage. It therefore recommended that they be retained.
- In Victoria, a 1997 review of physiotherapy regulations recommended the removal of restrictions on practice, the retention of registration requirements and the introduction of compulsory professional indemnity insurance.

Source: Jurisdictions (1998 legislation review schedule updates and information supplied to the Council).

1.6 Improving the competitiveness of government businesses

Improving the performance of government businesses has been an ongoing focus for all Australian governments since the late 1980s. Many studies and reviews provided widespread evidence of poor performance, including poor capital and labour productivity, overstaffing and excessive use of material inputs,

inappropriate management practices, poor quality goods and services, inappropriate pricing practices and poor financial performance.

Over the last decade, governments have been reforming their significant businesses in three ways:

- by restructuring them;
- by making them compete on an equal footing with private businesses, where this is in the public interest; and
- by monitoring their prices where the businesses retain monopoly power.

In 1995, these reforms were brought within the ambit of National Competition Policy. The early outcomes of reform are indicated in Box 4.

Box 4 Recent performance of government businesses

The Steering Committee on National Performance Monitoring of Government Trading Enterprises (1997) found improvements in the performance of government businesses over the four years to 1995-96. While the outcomes have varied between the enterprises studied, overall there were:

- improvements in labour productivity;
- a doubling of total payments to governments;
- average price reductions of around 15 percent; and
- some improvements in service quality.

The Steering Committee's October 1998 Report found that these trends were sustained over the period to 1996-97. The Report noted substantial price reductions for most Government Trading Enterprise (GTE) services, particularly electricity, port, telecommunications and air traffic services.

Box 4 ...cont

At the same time, the Report noted that the quality of services appears to have been maintained or increased for most GTEs in the period under review.

While significant price reductions occurred for residential services, some of the biggest reductions – for example in water and electricity – were experienced by business users. This is to be expected as some NCP reforms involve redressing previously existing cross-subsidies by reducing prices for business at a faster rate than those for household consumers. But these benefits to business also assist consumers – when reduced costs to firms are passed on to households through lower prices for goods and services.

Structural reform

Where a publicly owned business has developed into an integrated monopoly, there may not be sufficient incentives for the business to provide value for money services. One way to address this problem is for governments to consider structural reform of the monopoly. The NCP agreements call for a review of a public monopoly's structure whenever a government wishes to introduce competition to a market, or to privatise the monopoly. The review is aimed at determining the appropriate structure of the business to best serve the public interest, and takes account of a wide range of economic, social and environmental issues, including the best way of funding and delivering any mandated community service obligations.

It should be noted that NCP requires governments to examine structural reform only if a decision has already been made to introduce competition or to privatise a monopoly – but privatisation is not, in itself, required. The structural reform principles in NCP are neutral on the question of private versus public ownership.

Box 5 Privatisation

NCP does not require privatisation of any government business. The NCP agreements leave it to governments to determine whether privatisation is warranted in any particular circumstance. Where a government chooses to privatise a public monopoly, the NCP reforms require the government to undertake a review first to ensure, among other things, that the right competitive environment is in place for privatisation.

Hence, any decision by governments to privatise a public asset reflects a policy decision of the government in question — not a requirement of NCP.

That said, privatisation *is* one way (of several) by which governments can meet some of their obligations under the NCP agreements. For example, it can be one option for applying ‘competitive neutrality’ to significant government business activities (see below).

In addition, the Council recognises that NCP can sometimes result in governments giving stronger consideration to privatising certain businesses. For example, the introduction of competition may require a government business to undertake new investment to compete effectively in the market. In some cases, governments may have higher priorities for taxpayer funds. The high cost of upgrading the aircraft fleet, for instance, was one consideration underlying the privatisation of Qantas.

However, it is still up to individual governments to decide whether privatisation is warranted, and there will be cases in which it is unlikely to be. Privatising any particular publicly-owned business may or may not confer an overall community benefit. Consequently, the merits of privatising businesses need to be assessed on a case-by-case basis.

Structural reform of a public monopoly can advance the public interest for two reasons:

- some public monopolies have responsibilities for regulating technical aspects of an industry, as well as providing services that are subject to or affected by those regulations. In a competitive environment, such a dual role creates a potential conflict of interest.
- where privatisation of a public monopoly is contemplated, structural reform may be required to ensure that anti-competitive arrangements are not entrenched under private ownership.

Australian Governments have undertaken wide-ranging structural change of their big, monopolistic enterprises in the 1990s. As noted earlier, structural reform is an important part of the electricity, gas and water reforms. To quote other examples:

- New South Wales has broken up its State Rail Authority into seven smaller entities, each specialising in a particular facet of rail operations; and
- Victoria has restructured its port operations, putting responsibility for shipping channels in one body, and other wharf functions – which are amenable to competition from private businesses – elsewhere.

Competitive neutrality

‘Competitive neutrality’ measures seek to ensure that competition between public and private businesses happens on a fair basis, by making sure they face the same taxes, incentives and regulations. ‘Corporatisation’, ‘commercialization’ and ‘full cost pricing’ are some ways competitive neutrality can be introduced into government businesses. Under NCP, the application of competitive neutrality reforms to a particular government business is subject to a public interest test, taking into account relevant social, economic and environmental considerations (see Appendix 1).

Competitive neutrality reform can help governments and the community gain better value for money in service provision. Corporatisation or commercialisation can inject a government business with a sharper focus on customer needs and competitive pricing. Similarly, where governments provide services through competitive tendering, competitive neutrality helps ensure that the bids of each party are comparable. For example, without competitive neutrality, an 'in house' bidder could enjoy an unfair advantage over external contractors because of tax exemptions or access to various corporate overheads free of charge. Conversely, this 'bias' may favour external contractors in some cases. For example, an 'in house' bidder could be disadvantaged in a tender because of responsibilities to provide community service obligations.

But if competitive neutrality is applied, any advantages and disadvantages enjoyed by 'in house' bidders are made transparent and factored into the selection process to ensure that all tenders are considered on their merits. If this occurs, governments are in a better position to choose options that make the best use of taxpayers' money and deliver the best quality services.

To date, governments have corporatised or commercialised many of their businesses, and are progressively introducing pricing reforms to many others. Further, all governments have also established units to deal with any complaints about unfair advantages enjoyed by particular government businesses, as is required under the NCP agreements.

While the most significant benefits from competitive neutrality reform are likely to come from reforming the larger state-owned enterprises, local communities may also benefit from reforms which enable local governments to get better value for money from the rate base.

At the same time, there are often significant public interest considerations associated with local governments, particularly in remote locations. In these areas, regional development and employment factors can sometimes mean that the social and economic cost of introducing competitive neutrality may outweigh benefits arising from increased competition between public and private providers. This may sometimes point to reform being contrary to the public interest in rural and remote areas. But this is a matter which should be put to objective assessment

to determine the merits of the argument, rather than being the subject of an automatic exemption (see section 3.2).

Box 6 Competitive tendering and contracting out

Competitive tendering and contracting out are not requirements under NCP. As is the case with privatisation, any decision to provide government services through a tendering process is a policy decision for the government in question.

Many governments are choosing to provide a range of services through competitive tendering processes to improve value for money and quality of delivery. Where this occurs, it is important that the NCP requirement of competitive neutrality be first applied to ensure that the tender process is fair and delivers accurate signals to governments

It is important to note that competitive tendering does not necessarily mean contracting out – it can also be used as an approach to improve the quality of ‘in-house’ service provision. For example, prior to putting some of their functions to a competitive tendering process, some government bodies in Queensland and Victoria have provided training for their staff who undertook the relevant functions. This provided the staff with a better opportunity to win the work in open competition with the private sector or other government suppliers (see section 3.2).

Price monitoring

In some cases, reforms such as reviewing regulatory barriers to entry, competitive neutrality and structural reform may be insufficient to guarantee effective competition. This may occur, for example, where reforms need to be phased in over a period of time, or where important parts of the market remain largely dominated by a single firm.

Where government businesses retain monopoly power, the NCP calls on governments to consider subjecting them to independent prices oversight. All States and Territories, except Western Australia and the Northern Territory, have established independent prices oversight arrangements, and several government businesses are currently subject to prices oversight.

1.7 The broader policy mix

Competition policy can play a major role in enhancing the performance of the economy. Its strength lies in improving productivity and economic efficiency. This can directly improve people's material living standards and, in conjunction with other measures, enable the attainment of the community's social and environmental goals.

But while NCP is explicitly tailored to serve the public interest, competition policy should be seen as just one plank in a platform of policies to secure Australians' wellbeing and help us deal with our changing economic circumstances. Other policies – such as tax, social security, community services and labour market programs – also play a critical role in ensuring that the potential benefits of reform are realised in full and shared equitably.

The relationship between NCP and other areas of government policy is a theme examined more fully in the following sections of this paper.

2. Effects of Reform on Society and the Economy

2.1 Some broad perspectives

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

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

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

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

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

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

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

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

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

Box 7 Some early outcomes from competition reform⁴

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

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

Box 7 ...cont

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

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

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

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

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

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

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

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

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

the interests of the community at large.

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

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

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

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

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

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

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

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

2.2 Adjustment assistance

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.3 Effects on employment

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

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

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

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

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

⁵ Section A2.4 of the Annual Report.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.4 Equity and social welfare

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

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

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

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

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

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

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

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

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

Box 8 Anti-competitive regulation and equity: conveyancing

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

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

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

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

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

Box 9 Controls on entry into medical specialist professions

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

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

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

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

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

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

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

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

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

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

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

2.5 Community service obligations (CSOs)

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

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

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

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

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

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

As the Hawker Committee notes:

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

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

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

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

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

CSO issues also arise under other NCP reforms:

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

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

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

2.6 Effects on the environment

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

Water

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

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

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

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

Box 10 Water reforms for the environment in NSW

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

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

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

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

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

Energy

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

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

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

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

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

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

Other NCP reforms

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

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

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

3. Impacts on Urban, Rural and Regional Communities

3.1 Overview

There is little evidence to date on the relative effects of NCP reform on urban and rural and regional Australia. Monitoring these relative impacts is particularly difficult at present, given that NCP implementation is still in its early stages. The Productivity Commission is currently investigating this issue, and their review into the *Impact of Competition Policy Reforms on Rural and Regional Australia* is expected to provide important evidence on this matter.

The issue of competition policy and its effects on rural and regional communities has been the subject of considerable anxiety in the community. The concerns include fears that competition policy will cause a loss of services to the bush, that farmers will not be able to market their produce through co-operatives, that the prices of farm inputs like water will rise, that job opportunities will dry up and that any benefits from competition will go mainly to city people and big business. The Hawker Committee expressed particular concern in this regard in the case of rural and remote communities (Hawker 1997).

Some of these concerns do reflect uncertainty as to the potential impact of NCP in such areas as the reform of statutory marketing arrangements and water reform. But other concerns, such as the erosion of rural services, are more closely linked to changes in the Australian economy which have been taking place over recent decades, causing much social dislocation. Much of this hardship stems from declining business opportunities in rural communities caused by falling world

prices for agricultural commodities, improvements in farm productivity, and a population drift towards larger regional centres and the cities. Closures of banks, for instance, are commercial decisions which reflect dwindling commerce in many rural and remote areas, and have little or nothing to do with NCP.

But clearly, a number of areas of NCP are likely to have particular impacts on rural and regional communities. Many of the reforms offer substantial benefits to these communities – for example, the new water trading arrangements and the impacts of reform on reducing rail freight charges, energy costs and prices of imported farm equipment and fertilisers.

Sometimes, however, due to differences in scale between business activities in rural and urban areas, the benefits of reform may weigh more strongly in favour of urban communities enjoying access to markets with vigorous competition. And in some cases, particular regions or industries in rural areas may be directly exposed to the reform process, creating the potential for a considerable burden of costs.

As the Council acknowledged in evidence to the Hawker Committee during its review of the Council's 1996-97 Annual Report, these issues:

can only be tackled by governments dealing with universal service obligations and community service obligations. That is part of the ongoing regulation that will be required in any deregulatory regime to ensure that ... all Australians, wherever they live, should continue to receive an essential service and receive it at a fair price (as reported in Hawker 1998).

At the same time, the reform framework is designed to take account of these costs. The NCP public interest safeguards are designed to allow the costs and benefits of reform – including the impacts on individuals, regions and particular industries – to be weighed openly and rigorously to ensure that reform is in the interests of the community as a whole. This can sometimes require a delicate balancing of interests, but the reform framework is designed to ensure that the interests of all parties are considered, with any trade-offs made explicit. Where reform is found to be justified, but the distribution of costs and benefits weighs unfairly on a particular region or community, there is a case for governments to consider

compensatory measures – for example, through policies on regional development and the provision of well-targeted community service obligations.

Section 3 of this paper examines five key interfaces between NCP and rural and regional communities:

- local government reform (section 3.2);
- the review of legislation governing statutory marketing arrangements (section 3.3);
- the review of other anti-competitive legislation affecting the provision of services in rural and regional Australia (section 3.4);
- water reform (section 3.5); and
- reforms affecting the provision of services such as energy, rail freight, imported farm equipment, vehicles, and fertilisers in rural and regional Australia (section 3.6).

In each case, NCP can bring about certain costs for rural and regional communities. But if properly applied, the reforms also offer them significant benefits.

3.2 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 rural and remote areas.

Local government reform was well underway in several States prior to the implementation of NCP. One of the most significant changes has been the use of competitive tendering and contracting (CTC), most notably in Victoria.

The NCP package does not require the use of competitive tendering. However, two NCP reforms *are* required at the local government level – competitive neutrality and the review of anti-competitive legislation and regulation – provided the benefits of reform outweigh the costs. Concerns have been raised regarding the implications of competitive neutrality reform for local governments in rural and remote communities.

The competitive neutrality reforms include corporatisation of the larger government-owned business units, and applying full cost pricing to goods and services provided by significant local government businesses. The Hawker Committee noted concerns that such measures may result in unacceptable price increases for rural services, and that rural service providers may not be able to compete with service providers based in larger regional markets – resulting in an erosion of community capital and employment opportunities in outlying areas. These risks were thought to be heightened where a council puts its services to competitive tendering (Hawker 1997).

The Council has emphasised that while competitive tendering is not required under NCP, it can be one (of many) ways of implementing competitive neutrality. The implications of reform for local communities should be considered in assessing whether to apply such reforms, however – the public interest test set out in clause 1(3) of the CPA identifies that “economic and regional development, including employment...” should be taken into account. In its 1996 publication *Considering the Public Interest under the National Competition Policy*, the Council noted that this should encompass the implications for local communities:

In considering the relative merits of in-house and external provision, it is appropriate to examine factors in addition to the relative cost of in-house and external provision. One consideration is the value of keeping workers employed in a local region. Another is the convenience of having people readily available to provide a service (NCC 1996a).

For example, if a local government runs a tender for its waste collection services, the selection process should factor in such matters as the likely cost savings to ratepayers, the effect on service quality, environmental impacts and the impact on local commerce and employment. The Hawker Committee noted that the NCP public interest test provides adequate scope to recognise the special needs of small and isolated communities.

The Council reiterated this point in its 1997-98 Annual Report:

... there are often significant public interest considerations associated with local governments, particularly in remote locations. In these areas, regional development and employment factors may mean that the social and economic cost of introducing competitive neutrality may outweigh benefits arising from increased competition between public and private providers.

This may sometimes point to reform being contrary to the public interest in remote areas. But this is a matter which should be put to objective assessment to determine the merits of the argument, rather than being the subject of an automatic exemption.

While the adoption of competitive neutrality principles can pose some potential costs for rural and regional communities, it is important not to lose sight of the potential benefits. An outcome of NCP reforms is likely to be cost savings in service delivery, providing scope for reduced user charges, rates relief and a greater pool of funds for investment and other local priorities. Such results can assist local government in reconciling the community's expectations of improvements in welfare, recreation and community services in times of constrained revenue raising capacity.

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 minimise 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 delivered significant cost savings to the local community:

We commissioned independent costs estimates prior to inviting bids. The capital cost was estimated at \$25 m - \$26 m. We're paying (the service provider) \$23 m. The estimated operating cost at full capacity was \$2.3 m per annum, We will be paying \$1.3 m. Experience in both Australia and overseas has shown that savings such as these are not unusual... (Playford 1998).

The Noosa Council also offered adjustment assistance to ‘in house’ staff:

We offered our (existing operations) staff options for relocation within the organisation with retraining if appropriate or employment with the successful bidder.

While reform provides the opportunity to improve the effectiveness of service provision, there may be additional benefits. The reform of council regulations that are unnecessarily stringent offers scope to reduce business costs and can improve the ability of the local area to attract private investment. This may encourage economic activity in the local region and expand job opportunities.

Competition reform may also improve the quality of council governance by helping to identify the true cost of providing services, including community service obligations. The Council of Capital City Lord Mayors has argued that this provides for a superior information base that can be expected to lead to more focussed debates about community priorities and the best use of council resources (CCCLM 1996). It also encourages a shift away from artificially low prices for goods such as water, which in the past has encouraged wasteful overconsumption, environmental degradation, and investments that do not recover their cost.

Under the NCP framework, governments and independent reviews will often recognise that reform offers a net benefit to the local community, while still imposing certain costs. Under the NCP framework, such an outcome would point to proceeding with reform. The Hawker Committee argued the need for innovative thinking in the approach to competitive neutrality in rural areas to allow councils to retain skills and expertise, ownership of infrastructure equipment and so on:

For example, options for doing this include phasing in tendering over time; councils in a region specialising and sharing services etc.’ (Hawker 1997).

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. According to the Ballarat City Council, this process was used in conjunction with local government amalgamations as a driver of cultural change towards ensuring that ratepayers receive best value for money. The approach includes defining areas of services vital to the local council, targeting areas of expertise with which to develop new businesses and aggressively compete outside the local area (and hence generate new employment opportunities in the local area), and identifying areas of service which should be outsourced or be market tested. Janet Dore, CEO of Ballarat City Council notes that “the results have been varied, but predominantly positive.”

Ms Dore also believes that the reforms are likely to lead to changes in the structure of work forces and industrial relations:

The industrial relations impact of competitive tendering is continuing to evolve whereby umbrella Enterprise Agreements are likely to be replaced by Local Work Agreements to reflect the particular needs of Business Units. Clearly the requirements for Garden and Parks crews with respect to work practices, hours and offsets will be different from those of the Home Care service (Dore 1998).

The approach to local government reform 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. The funding for this adjustment package comes as part of a series of targeted transfers from the State Government over five years, totalling up to \$150 million.

Part of the package is tied to training and assistance initiatives to bring local governments and their employees up to speed on principles of commercialisation and full cost pricing. For example, the Gold Coast City Council in 1998 ran a series of training courses – conducted both in-house and externally – covering topics that included ‘internal service level agreements,’ ‘full cost pricing training,’ ‘business planning,’ ‘people management,’ and ‘contract management and tendering.’

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.

Another approach to minimising the costs of reform lies in the *timing* of implementation. The Council recognises that local governments in rural and remote areas are likely to have a narrower skills base than those in urban areas and larger regional centres. For this reason, there may be advantages in setting priorities such that reform is applied to larger local government bodies ahead of smaller ones. In this way, smaller local government bodies can adopt models which have already been developed, rather than having to ‘reinvent the wheel.’

3.3 Reviewing legislation governing statutory marketing authorities (SMAs)

An area of the legislation review program with direct relevance to rural communities is the review of statutory marketing arrangements (SMAs). The review of SMAs is important because arrangements underpinning them are prima facie anti-competitive. Typically, they include centralised marketing boards with powers to compulsorily acquire or vest the entire crop, set quality grades and prices, and act as the single seller of the acquired product on either or both the domestic and export markets. In short, producers can sell their product only to the marketing body and customers can buy the product only from the marketing body.

Proponents of SMAs argue that the arrangements offer the following benefits:

- maximising grower income;
- stabilisation of prices, production and/or producer income;
- achieving price premiums based on market power, particularly in export markets;
- achieving economies of scale in marketing; and
- countervailing the market power of buyers and corrupt international markets.

Some critics argue that reforming SMAs is skewed against rural communities, offering benefits to urban dwellers – through cheaper farmgoods – while imposing significant costs on the rural farming communities exposed to reform.

But freeing up compulsory marketing structures can offer significant potential benefits to *both* rural and urban communities, including:

- freedom for primary producers to choose how, when and to whom they sell their crops, and freedom to negotiate sale prices;
- greater control by farmers over their production, marketing and risk management decisions;
- reduction in the share of a farmer's income soaked up in administration costs;
- greater incentives and opportunities for individual farmers and rural communities to undertake more innovative marketing and to invest in higher-value post-farm production;
- potential growth in industries which are major consumers of agricultural products such as food processing; and
- benefits to consumers through wider choice of supplier.

At the same time, there is a evidence to suggest that the perceived benefits of SMAs may be overstated – a number of important agricultural industries have prospered *without* statutory marketing monopolies (see Box 11).

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

Assessment of the costs and benefits of restrictions on competition imposed by SMAs need to be considered on a commodity-by-commodity basis. For example, whether an SMA can exercise enough market power to obtain price premiums on export markets will depend partly on Australia's relative significance as a producer. And where price premiums exist, these may be due to factors other than market power – for example, marketing strategies or economies of scale in transport.

Box 11 Agricultural industries without statutory marketing monopolies

Some of Australia's large agricultural industries have SMAs acting as monopoly sellers on domestic or export markets. However, many agricultural industries have developed and prospered in the absence of these types of marketing arrangements. Some examples are provided below.

Cotton

Australian raw cotton is marketed under a competitive market system.¹⁰

- Exports, which today account for more than 90 percent of the total cotton crop, have risen from less than 6000 tonnes in 1976-77 to over 310 000 tonnes (or \$760 million) in 1995-96.
- Average returns in the cotton industry have been substantially higher than in most other agricultural industries over the past decade.
- Cotton growers have survived and prospered through achieving economies of scale and applying sophisticated production technologies and marketing strategies.

Winegrapes and wine

Australian winegrape and wine industries are largely free from statutory marketing arrangements.¹¹

¹⁰ The Queensland Cotton Board operated as a statutory marketing authority in Queensland until 1989, at which time the industry was deregulated (with producer support) bringing it in line with New South Wales.

¹¹ The one exception is in the Murrumbidgee Irrigation Area in New South Wales, where the Wine Grapes Marketing Board has the capacity to act as a single seller of grapes from the region. Following a review of these arrangements, the Board's vesting power is to be extended until 31 July 2000 and then cease. The Australian Wine and Brandy Corporation administers export licensing arrangements and labeling standards, as well as undertaking some generic industry export promotion.

Box 11 Winegrapes and wine ...cont

Wine exports have increased from just 11 million litres in 1985-86 to 194 million litres (or a record \$813 million) in 1997-98. Expectations are for continued strong export growth.

Export success has been achieved through focused brand development, strong distribution relationships, the use of high technology and, more recently, a greater emphasis on higher margin red wines.

Red meat

In 1997, a producer-owned company, Meat and Livestock Australia, was established to undertake most of the research, development and promotion activities previously carried out by two statutory authorities, the Australian Meat and Livestock Corporation and the Meat Research Corporation.

As before, there are no single desk marketing arrangements under the new arrangements.

Annual beef production is valued at around \$4 billion, with sheep and lamb production valued at around \$150 million and \$420 million respectively. Exports of meat and livestock totalled \$3.4 billion in 1995-96.

Sources: ABARE (1996), NFF (1998), ACIL (1998).

At the same time, allowing an SMA to control export and domestic markets to extract higher export prices can impose costs on domestic consumers. For example, a monopoly desk allows opportunities to manipulate *both* export and domestic markets, and the capacity to short supply domestic consumers and extract monopoly prices. This tendency is reinforced where import restrictions apply on the domestic market. A likely consequence of extracting price premiums on domestic markets above and beyond prices which can be earned on export markets is the loss of processing and value-adding activities overseas – and the

loss of potential industries and jobs that could otherwise have been kept in Australia, often in rural communities.

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, recent 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.

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 market.

3.4 Reviewing other anti-competitive legislation

While the review of SMAs is of direct relevance to rural communities, several other areas of legislation and regulatory review also raise issues – such as reviews of legislation affecting the provision of services by the professions, retail services such as petrol and newsagencies, and essential services such as post and telecommunications.

There are widespread concerns that reforming legislation governing the supply of services such as petrol and newsagencies may result in an expansion of services in larger regional centres at the expense of small businesses in outlying rural and remote communities – with adverse implications for social cohesion in these communities.

These are legitimate concerns that should be taken into account in cost-benefit assessments of whether reform is in the public interest.

In considering this issue, it is important to consider whether the loss of services in small communities is the result of NCP – or whether it reflects wider issues of demographic change and economic change which has been affecting rural Australia over several decades. As noted earlier, the loss of particular services in some rural communities is closely linked to dwindling populations and declining business opportunities stemming from a long-term decline in commodity prices and improvements in farm productivity. Another factor has been shifting preferences towards shopping in larger regional centres, where prices for many products are often lower than in outlying rural areas.

It is true that regulatory reform can sometimes be one factor contributing to the loss of particular services in small communities – 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 result in cheaper petrol 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 some cases, an NCP review may find that socio-economic costs of this kind outweigh the community benefits of reform – such as cheaper services – suggesting that reform should not proceed.

In other cases, reform may still be found to confer a net community benefit – despite imposing socio-economic costs on particular regions or communities. For example, it may be found that there are better ways to address the socio-economic costs of dwindling populations and loss of commerce in the bush than to block NCP reform. After all, NCP is about reducing costs for people in the bush – and failure to implement may only aggravate the disadvantages already facing rural communities.

Instead it may be more appropriate for governments to consider the use of policies more specifically targeted at the kinds of socio-economic concerns discussed above – for example, through the provision of well-targeted community service obligations, and rural and regional development policies structured to develop value-adding industries in rural communities.

While acknowledging that some reforms may impose socio-economic costs on rural communities, there is also evidence that regulatory reform of such areas as legal services and optometry can *improve* access to these services in rural areas – for example, by removing overly rigid regulatory barriers to the supply of these services.

For example, the decline in rural populations has threatened the availability of services such as solicitors, physiotherapists and optometrists in many communities. But regulatory reform, such as removing the monopoly enjoyed by lawyers over conveyancing¹², has reduced conveyancing fees and promoted greater access to conveyancing services.

¹² In States and Territories other than Queensland.

The Victorian Government has informed the Council that as a result of deregulation in that State, a number of professional services in rural areas are now becoming 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.

The Council's approach to the impacts of reform on different segments of the community is reflected in its recent review of the *Australian Postal Corporation Act 1989*. The main focus of the Council's considerations was directed at how Australia Post's social responsibilities can be maintained and strengthened, while maximising the benefits from competition. The Council viewed the social objectives as fully justified and dismissed options for increasing competition which compromised these objectives.

In accord with this approach, the Council's report contained twelve recommendations to maintain or increase services to rural areas and strengthen guarantees that those services be maintained (see Box 12).

Box 12 Some of the Council's recommendations for postal services

The Council's recommendations on postal services reform included the following matters:

- retention of Australia Post's obligation under law to deliver letters throughout Australia;
- retention of the uniform rate for postage for household mail;
- better definition of Australia Post's letter delivery obligations above the standard of reasonableness in the legislation;

Box 12 ...cont

- a plain english service charter to make Australia Post's CSO obligations clear to the general public;
- independent monitoring of the delivery of CSOs to ensure Australia Post meets its obligations;
- measures to better monitor Australia Post's delivery performance standards, particularly in rural and remote areas;
- guaranteed continued funding for CSOs;
- more options for people to obtain a delivery service to the property in cases where they currently receive a service to the post office in the closest town;
- monitoring the new Rural Delivery Frequency Guide Formula to ensure it operates equitably;
- better reimbursement for people working in more remote locations who deliver post office services through community postal agencies;
- fairer community voting processes for changes in services; and
- abolition of annual fees in relation to private bags and locked bags.

3.5 Water reform

Another significant element 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 assisted rural communities – irrigated land currently produces a quarter of Australia’s agricultural output and sustains employment in dozens of rural towns (*Australian Financial Review*, 18 August 1998).

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 seek 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 a seven year period, to give rural businesses and communities plenty of advance notice and time to plan and adjust. The reform process also requires significant involvement of farmers and rural communities.

A central reform is the shift towards full cost recovery in rural water pricing by 2001. 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, arguably giving their farmers an unfair competitive advantage.

While the reforms will impose pain on some rural communities, *failure* to implement the reforms would involve much higher costs – degradation of our rivers coupled with a deterioration in water quality to the point where the demand for water cannot be met, rising salinity in groundwater and soils in farming areas, continued depletion of fish stocks and so on. The reform measures aim to safeguard the sustainability of water resources and ensure that water infrastructure will be properly maintained. At the same time, governments should consider the need for adjustment assistance to help irrigation farmers adjust to the changes. As noted earlier, NSW recently announced a comprehensive water adjustment package (see section 2.2) addressing these issues.

An important benefit for farmers is likely to flow from a new system of secure water allocations and permanent trading in water. Caps on total water diversions will address environmental issues, while trading will allow farmers to sell some or all of 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-added 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 could make extra profits in their area or industry by buying extra water allocations will be able to do so.

In essence, water trading will encourage a shift away from crops which use a lot of water for poor returns, towards higher value added 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. At present, more than 40 per cent of irrigation water goes to low value pasture activities.

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. The top margin was over \$5000.

These figures suggest that water transferred out of broad-acre cropping into winegrapes or stonefruit, for example, will boost rural profitability. There is not infinite scope for doing this of course – for example, the cost of water is not the only factor determining the profitability of a crop. But the substantial increase in wine exports in recent years, up 25 percent in volume terms in the last year alone to a record \$813 million, gives an indication of what can happen.

In the past, water rights were permanently attached to land and thus could not be traded or shifted. This prevented farmers from responding to new market opportunities, impeded productivity, prevented more fertile soils from being brought into production, and worked to lock in rural poverty. As the competition policy reforms are introduced, these problems can be overcome.

Governments are presently at various stages in introducing intrastate trading regimes. In those States where trading exists, the benefits are significant. In the Victorian horticulture and dairying industries alone, the projected benefits of intrastate water trade are about \$50 million a year in additional agricultural output.

Trading *between* States is also being introduced. While early implementation problems are currently being ironed out, interstate trade has the potential to provide further significant benefits to the rural economy. For example, the Murray Darling Basin Commission is presently conducting a trial trading project between NSW, Victoria and South Australia that will be extended to include irrigation districts. 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 (*The Age*, 21 September 1998).

Interstate trade will bring substantial benefits – especially in drought years. Traded water would help preserve the highest value crops, which would be of national as well as State and regional benefit.

3.6 Other NCP reforms

While local government reform, regulatory reform and water reform all offer the potential for significant benefits to rural communities, the rural sector is also poised to benefit from a number of other NCP reforms:

- energy reform has delivered cuts in power bills of 25 to 30 per cent for some businesses covered by the national electricity reforms. Meanwhile, gas haulage prices in Western Australia will fall by 19 per cent, and by up to 60 per cent in NSW by the year 2000 (NCC 1998a). 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.
- rail reform is delivering cheaper freight rates. For example, rail 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. 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. Rail services overall are about 11 per cent cheaper in real terms compared to 1991-92 (NCC 1998a, SCNPMGTE 1998).
- port authority service prices fell by 23 percent in real terms between 1991-92 and 1996-97 (SCNPMGTE 1998).

The Commonwealth Government's tariff reduction program is another example of the potential benefits of open trade to rural communities. Tariff reform has led to cheaper costs for imported farm machinery, vehicles, spare parts and fertilisers, improving the competitiveness of primary producers. At the same time, the shift towards freer trade internationally has improved market access for Australian exporters, creating opportunities for maintenance or growth in rural incomes.

4. The Public Interest Test

4.1 Role of the 'public interest' in National Competition Policy

As has been emphasised throughout this paper, governments agreed to implement the NCP package because they could see that the reforms would play a major role in enhancing the performance of the economy and the welfare of the community as a whole.

The Council has consistently argued – in its Annual Reports, publications such as its 1996 explanatory booklet on Public Interest matters (NCC 1996a), and in speeches and parliamentary briefings – that NCP reform is about competition as a *means* rather than an end in itself. The aim is to use competition to improve productivity, lower prices, improve standards of service and enhance the community's living standards and employment opportunities.

While the NCP package in its entirety was designed to serve the public interest, many of the individual reforms are subject to additional safeguards to weigh the costs and benefits of reform on a case-by-case basis. These public interest safeguards arise in several contexts of the NCP program:

- 1 The merits of proceeding with three key reforms – competitive neutrality, the structural reform of public monopolies, and the reform of anti-competitive legislation – are subject to a public interest test set out in clause 1(3) of the Competition Principles Agreement.
- 2 One of the criteria for declaring infrastructure services for third party access under the Trade Practices Act (TPA) is that access must not be contrary to the public interest.

- 3 Authorisation of anti-competitive practices prohibited by the TPA can be sought from the ACCC on the grounds net public benefits.
- 4 The Council may be called upon to weigh the costs and benefits of Commonwealth, State or Territory laws providing statutory exemptions from the TPA.

4.2 Clause 1(3) of the Competition Principles Agreement

Under clause 1(3) of the Competition Principles Agreement (CPA), the merits of applying three central NCP reforms – competitive neutrality, the structural reform of public monopolies, and the reform of anti-competitive legislation – should be determined on a case by case basis by applying a public interest test.

The public interest test was written into the NCP framework to allow *all* relevant factors to be considered when deciding whether restrictions on competition are warranted. The test provides for consideration of an array of public interest matters, including the environment, employment, social welfare and consumer interests as well as business competitiveness and economic efficiency (see Appendix 1). The public interest test in clause 1(3) is neither exclusive nor prescriptive. Rather, it provides a list of *indicative* factors a government could look at in considering the benefits and costs of particular actions, and allows governments to also take other factors into consideration.

Weighing benefits and costs involves difficult judgements which can only be assessed on a case-by-case basis. This is because a broad range of considerations will apply, and not all will be relevant in every circumstance.

The Council's approach, as outlined in its 1997-98 Annual Report, is that the NCP agreements give social and environmental values no more or less weight than

financial considerations in determining where the public interest lies. In other words, the presumption is that all public interest considerations intrinsically carry equal weight.

For example, a review into the merits of a statutory marketing arrangement should consider such matters as the impacts of barriers to competition on the level and stability of farmers' incomes, the welfare of Australian consumers, implications for the value of Australian exports, environmental impacts, administrative and regulatory costs, effects on regional development and employment, economies of scale in transport and marketing, agricultural productivity and implications for value-adding industries.

A challenge for review bodies and for governments is to focus on outcomes that benefit the *community as a whole*, rather than providing special treatment for certain groups at the expense of others. Most anti-competitive restrictions benefit someone. But where this imposes costs on others (such as forcing consumers to pay higher prices than would otherwise be necessary), it is important that each side of the argument be weighed in an objective and transparent manner.

At the same time, it is important that the impacts of reform on the individuals, regions and industries directly exposed to reform are taken into account. It is also important that any trade-offs between the interests of different groups are made explicit so that governments can objectively consider whether compensatory measures are warranted.

For these reasons, the Council has consistently stressed the importance of independent, transparent and rigorous *processes* by governments in considering public interest matters. This is essential to maintain community confidence that public interest considerations have been objectively examined. The Council's position on this matter is also reflected in the approach endorsed by the Hawker Committee (Hawker 1997, Recommendation 1).

Once public interest considerations have been rigorously assessed in an independent and transparent forum, the best course of action – whether to implement reform or not to do so – will be apparent, and the public interest would be best served by governments adopting the recommendations accordingly.

A number of State and Territory reviews have recommended that restrictions on competition be retained in the community interest. Where these reviews use transparent, independent and objective processes, the Council has accepted these outcomes as satisfying the intent of the NCP agreements.

The degree of rigour required in a public interest assessment depends to some extent on the circumstances. For example, the Council does not seek to promote excessively bureaucratic processes for relatively minor matters.

Conversely, it would not be appropriate to *exempt* an area from reform without first conducting a rigorous cost-benefit analysis – to do so would be to invite claims that reform has been suppressed to satisfy vested interests. Similarly, where the net public benefit is unclear, or where there are claims that reform is against the public interest, decisions should be based on an objective assessment of the facts.

In general, the process followed should reflect the significance and complexity of the particular reform or issue (taking into account such matters as the range of affected stakeholders and community sensitivity). As a minimum, however, interested parties should be given the opportunity to participate and should have confidence that their views will be taken into account and given due consideration.

The process for *measuring* costs and benefits requires judgement. The Hawker Committee cited a range of approaches currently in use, but accepted the use of both quantitative and qualitative assessments where appropriate. It also noted the need for greater guidance to local governments in the practicalities of conducting public benefit assessments. The Council notes that this problem is now being addressed in Queensland with comprehensive training programs, and encourages the wider use of this approach.

In considering community benefits and costs, it is important that both short-term and longer-term factors are taken into account. It is often the case that the costs of reform – such as employment losses in firms directly exposed to reform – are short-term, upfront and concentrated, whereas benefits – such as cheaper prices to consumers and flow-on benefits of new jobs elsewhere in the economy – are often longer term and widely dispersed throughout the community. For this reason, a “first glance” consideration may only provide part of the overall picture.

4.3 Third party access to infrastructure

In considering an application to declare infrastructure services for third party access under Part IIIA of the Trade Practices Act (see section 1.4), the Council must consider, among other things, whether access would ‘not be contrary to the public interest.’

The expression of this criteria in the negative reflects the fact that other criteria for access already consider a number of public interest matters – for example, access must promote competition, avoid wasteful duplication of infrastructure, and not put human health and safety at risk.

The term ‘public interest’ is not defined in the TPA – and the definition in clause 1(3) of the CPA does not apply for the purposes of the Act. However, the Council indicated in its 1996 publication *The National Access Regime* that in considering this matter, it would weigh any benefits of access regulation (such as cheaper prices and more efficient use of resources) against costs (such as regulatory and compliance costs). The Council indicated that the environment, regional development and equity are other public interest matters that might arise in the context of access regulation.

For example, in its recommendation to the Commonwealth Treasurer on an application for declaration of certain rail freight services in Queensland (NCC 1997b), the Council considered a range of public interest issues advanced by some parties against declaration. These included:

- the concurrent development of a State access regime covering the service;
- the implications for a nationally consistent approach to rail reform;
- implications for investment;
- effects on economic efficiency; and
- implications for industrial relations, employment and regional development.

4.4 Authorisation and notification under the Trade Practices Act

Authorisation of anti-competitive practices prohibited by the TPA can be sought from the Australian Competition and Consumer Commission (ACCC) on the grounds that there is a net public benefit from maintaining the practice.

Notification is a similar process conferring automatic immunity from the competitive conduct rules upon notification of particular conduct to the ACCC.

In effect, each process recognises that some restrictive trade practices provide net benefits to the community.¹³

The meaning and import of the 'public benefit' under the TPA does not rely on a legislative definition, but on judgements made in previous cases. The ACCC and the Australian Competition Tribunal recognise the public benefit to include:

- the promotion of competition in an industry;
- economic development, eg in natural resources through encouragement of exploration, research and capital investment;
- fostering business efficiency, especially where this results in improved international competitiveness;
- industry rationalisation, resulting in more efficient allocation of resources and in lower or contained unit production costs;
- expansion of employment or prevention of unemployment in efficient industries and employment growth in particular regions;

¹³ The ACCC has the power to grant an authorisation for anti-competitive agreements, primary boycotts, exclusive dealing arrangements, resale price maintenance agreements, and mergers which lessen competition. The ACCC cannot grant an authorisation for the misuse of market power. Notification provides immediate immunity from legal proceedings for exclusive dealing, and immunity for third line forcing at the end of the prescribed period from the time that the ACCC receives the notice.

- industrial harmony;
- assistance to efficient small business, for example guidance on costing and pricing or marketing initiatives which promote competitiveness;
- improvements in the quality and safety of goods and services and expansion of consumer choice;
- supply of better information to consumers and business to permit informed choice in their dealings;
- promotion of equitable dealings in the market;
- promotion of industry cost savings resulting in contained or lower prices at all levels of the supply chain;
- development of import replacements;
- growth in export markets; and
- steps to protect the environment.¹⁴

In making judgements about a particular case, the ACCC seeks factual evidence of benefits and costs to assess whether the net benefit to the public would outweigh the likely anti-competitive detriment. The goal of economic efficiency is often central in defining whether a public benefit arises, although there may be other benefits in its absence.

For governments facing requests from sectional interests for 'special treatment', the authorisation process provides a systematic, arms length assessment of the public benefit. Thus, an advantage of requiring an interested party to apply for its activities to be authorised by the ACCC is that the public benefit of the activities must be justified in an independent forum. Adoption of such an approach on a

¹⁴ This list was cited by the Commission in *Re ACI Operations Ltd* (1991) ATPR 50-108 and is published in brochures by the ACCC for public use

consistent basis could reduce the pressure on governments to exempt anti-competitive behaviour through other means such as statutory exemptions (see below).

4.5 Statutory exemptions – s 51 of the Trade Practices Act

In some special cases a government may prefer to exempt the conduct of market participants from Part IV of the TPA by passing its own legislation to provide that protection, rather than obliging them to apply to the ACCC for an authorisation. Statutory exemptions of this kind can be provided under section 51 of the TPA.

Under the *Conduct Code Agreement*, States and Territories must provide written notification to the ACCC of any legislation reliant on section 51 within 30 days of the legislation being enacted. However, the Commonwealth Minister has the discretion to override such legislation. If the Minister wishes to override the legislation after four months or longer have elapsed, the Minister must call on the National Competition Council to report on:

- whether the benefits to the community from the legislation 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 State or Territory legislation.

While the Conduct Code Agreement does not specify the form of the test the Council should apply in reporting on community benefits and costs, the Council indicated in its 1996 publication *Considering the Public Interest under the National Competition Policy* that it would apply the factors listed in clause 1(3) of the CPA.

Appendix 1: The NCP Public Interest Test

Under clause 1(3) of the Competition Principles Agreement, governments take into account the following factors when assessing the merits of reforms in relation to competitive neutrality, anti-competitive legislation and the structure of public monopolies:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations 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 businesses; and
- the efficient allocation of resources.

The list is open-ended, meaning that any other relevant matter should also be considered when assessing the case for a competition reform.

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National Competition Policy: Some Impacts on Society and the Economy

1 Community consultation is vital

The Council supports governments in explaining to the community the important connections between competition reform, other government policies, and community objectives such as full employment, equity and environmental goals.

The Council sees its communications role as crucial, given that many of the reforms are complex and involve change – which can create conditions of uncertainty in the community. Three recent Parliamentary inquiries into the Council and the NCP program have emphasised the importance of community consultation and communication (*pages 27-28*).

2 The central contribution of NCP

The central contribution of NCP is to help reduce prices to Australian households and costs to businesses, fuelling rising living standards, and making our industries more cost competitive. These changes create conditions for higher economic growth and sustainable job creation. They also help provide growth in the revenue base of governments, creating funds for important programs such as community services, welfare and protection of the environment (*pages 5-6, 8*).

3 NCP has checks and balances to serve the community

The Commonwealth, State and Territory Governments agreed to implement the NCP package in 1995 because they could see that it would enhance Australia's living standards by improving productivity, lowering prices and improving standards of service.

It was also understood that some of the reforms could bring a complex mix of costs and benefits – which might sometimes be spread unevenly across geographical regions, industries and individuals. For this reason, several key reforms were tied to a public interest hurdle to ensure that change is in the community's interest. The public interest test is broadly based, with monetary values given no more weight than social and environmental considerations (*pages 3-6, 48-50, 96-98*).

For example, if a particular reform is likely to damage commerce in a country town, this *could* be a valid reason to shelve the idea. Alternatively, reform may still be warranted if it is likely to bring other benefits, such as cheaper prices in rural communities – but

governments should look at whether the affected community needs assistance to adjust to the change (*pages 53-56, 74-75, 77-79, 87*).

4 Equity and CSO issues

The importance of equity and community service obligations (CSOs) are recognised in the NCP public interest test. For example, governments are free to transparently subsidise important community services for well-targeted groups – such as aged pensioners – under the NCP reforms.

Some reforms expose previously sheltered areas of the economy to competition – creating the risk of lower incomes, business failure or unemployment for some of the people concerned. But without reform, anti-competitive arrangements enable some people to maintain high incomes at the expense of others in the community.

There are other ways in which NCP can improve equity. For example:

- NCP is promoting cheaper prices for essential services such as electricity – which will help relieve a significant burden for low-income families.
- Reforms like competitive neutrality improve government finances, helping to safeguard important CSOs which may otherwise be threatened by budgetary constraints.

Often, the best approach will be to reap the benefits of reform, and consider ways of addressing any adverse effects on previously sheltered groups – eg, through well-targeted CSOs, social security policies and labour market programs (*pages 60-67*).

5 NCP and the bush

Some groups have raised concerns that the NCP reforms are skewed against rural Australia, in favour of urban communities. But the reforms can benefit rural Australia in a number of ways. In fact, the reforms can help mitigate some of the pressures in rural areas caused by dwindling populations and declining business opportunities, that stem from a long-term decline in commodity prices and better farm productivity (*pages 73-75*).

- Local government reform can help cut the cost of rural services and bring relief for ratepayers. But reform should be considered on a case-by-case basis to ensure that the benefits outweigh any associated costs – eg possible damage to regional commerce or employment – and should be designed in ways to minimise these costs (*pages 75-80*).
- Recent reviews into statutory marketing arrangements for products such as rice, barley and sugar have been tailoring their recommendations to the circumstances of each

industry, and proposing changes which benefit both rural communities and consumers generally (*pages 81-85*).

- Some rural communities have been losing services such as banking and petrol stations due to declining business opportunities in the bush (see above). NCP reforms sometimes have the potential to aggravate this process. For example, reforms to petrol supply arrangements may contribute to the closure of some petrol stations in outlying communities, with supply becoming more centralised in larger regional centres. This is likely to bring cheaper prices for services due to greater economies of scale. At the same time, it may cause the loss of a valued shop which provides commerce and a focal point for a small community.

If socio-economic costs of this kind outweigh the benefits of reform – such as cheaper services – there may be a case not to go ahead with the reform. On the other hand, the reforms can bring important price relief to rural communities, and there may be better ways to address any associated costs – eg, through community service obligations to ensure that necessary services are provided, and rural development policies to develop new value-adding industries in affected communities.

There is also evidence that regulatory reform of areas such as legal services and optometry, can *improve* access in rural areas – for example, by removing overly rigid regulatory barriers to supply (*pages 86-89*).

- Concerns have been raised that the water reforms will raise the price of water – especially for irrigation – imposing pain on farming communities.

But the water reforms are averting much higher costs for rural communities. Higher prices for bulk water are needed to promote better use of scarce water resources and halt the degradation of rivers, rising salinity in groundwater and soils in farming areas, and depletion of fish stocks.

The water reforms also offer new benefits targeted at rural Australia. For example, the water trading arrangements will allow farmers to boost their incomes by trading water entitlements. At the same time, governments should look at ways of helping farmers adjust to higher costs for bulk water. NSW has already announced a \$33 million scheme of this kind (*pages 90-92, 33-35, 54-55, 68-9*).

- NCP and related reforms are bringing cheaper costs for freight, imported farm equipment, vehicles, and fertilisers (*page 93*).

6 NCP is improving gas, water and electricity services

Although the NCP infrastructure reforms are at a relatively early stage, they are targeting issues such as security and quality of supply, as well as price.

- The NCP gas and electricity reforms are starting to deliver cheaper energy prices, and service standards are being improved or maintained (*page 31-32*).
- The NCP gas reforms were critical to the construction of the new NSW-Victoria 'interlink' gas pipeline in 1998. The new pipeline satisfied emergency gas needs, and averted a long-term collapse of the Victorian gas network following the Longford disaster last year (*page 32, 51*).
- The NCP water reforms include measures to improve the quality of drinking water, better monitoring standards and improved catchment policies. The importance of these reforms was highlighted by the crises over drinking water quality in NSW and South Australia last year. NSW announced a package of reforms late last year – including structural reform of Sydney Water – consistent with the NCP framework, to address these issues (*pages 50-51*).

7 NCP is environmentally aware

The environment is given explicit consideration in the NCP public interest test, and ecological concerns are a driving force behind the NCP water reform program.

- The NCP public interest test gives the environmental impacts of reform as much consideration as matters such as prices and business competitiveness. For example, a 1995 review of the South Australian Water Resources Act found that anti-competitive restrictions in the Act were justified because they mitigate the risk of environmental degradation (*page 71*).
- The NCP water reforms are largely a response to the need to halt the degradation of Australia's rivers and water supplies. Pricing reforms are designed to make people think about the way they use water and promote better conservation. The water reforms also recognise the environment as a user of water, with a right to a share of water allocations in the same way as consumers and industry. Under another key reform, the construction of new dams in future can only be undertaken following appraisal of economic viability and ecological sustainability (*pages 68-69, 90-92, 33-35, 54-55*).

The Australian Conservation Foundation recently described the water reform package as "ground-breaking" (*Habitat Australia*, August 1998).

- The NCP energy reforms are also likely to have environmental benefits, including the promotion of 'green energy' trade; an expansion in natural gas consumption relative to coal and petroleum products; and by discouraging unnecessary investment in infrastructure such as power stations (*pages 70-71*).

8 Effects on employment

NCP will affect employment in a range of ways – both positive and negative. While quantitative analysis is difficult, the impacts of NCP on Australia's cost competitiveness, international trade and economic growth should provide scope for net gains in employment.

There are also signs that NCP and related reforms are helping to improve the productivity and flexibility of Australia's economy, reducing our vulnerability to external shocks such as those currently affecting Asia. To the extent that NCP can help fire-proof us from external shocks, it may be helping to cushion the impact of overseas recessions on the domestic jobs market.

Even so, employment gains from NCP are likely to flow unevenly, with expanded job opportunities in many sectors and regions occurring alongside contractions in some others. It is important that NCP be implemented in conjunction with policies to deal with these impacts – eg education and training programs to enhance the vocational skills of unemployed workers and young people about to enter the labour force (*pages 57-60*).

9 NCP is not a 'stand alone' policy

The comments on employment reflect a wider principle acknowledged throughout the paper. Some reforms, while bringing important benefits – such as lower prices and better quality services – may impose costs on particular groups directly exposed to reform. The Council argues that to get the maximum benefit, NCP should be implemented in tandem with policies designed to manage these distributional effects – for example, education and training programs, tax and social security policies, policies addressing the level of community services, and regional development policies. In this way, the potential benefits of competition reform can be fully reaped, shared equitably and put to the best use (*pages 2, 53-56, 60, 64, 74, 78-80, 87-89, 91*).