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Competition Policy Review Secretariat
The Treasury
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SUBMISION TO THE COMPETITION POLICY REVIEW

National Billing Group Pty Ltd and its operations arm Cabfare Pty Ltd (collectively NBG) have reviewed the Competition Policy Review Issues paper. Set out below is NBG's observations on what we perceive to be systemic flaws that arise in the regulatory frameworks in Australia. NBG believes that consideration of these would assist a comprehensive review of Competition in Australia.

NBG is aware that the Review' s Policy paper notes, *"Other comprehensive reviews will potentially cover aspects of competition at a sectoral level, such as the Financial Systems Inquiry."* But the experience of NBG is that systemic issues arise from reliance on sectoral/industry-based approaches to competition that significantly impact on extracting the productivity benefits of competition. Accordingly we urge the Inquiry to delve into the following:

1. The merits of relying on industry regulators for competition reform and whether this can result in suboptimal policy outcomes.
2. The problems of regulatory capture that occur when reliance is placed on industry regulators to deliver competition. There are good examples of this occurring at both State and Commonwealth level where industry regulators have been entrusted with regulation outcomes or consumer protection.
3. The potential for gaps to emerge when economic regulatory functions for an industry is split across several agencies rather than relying on a single competition regulator.

NBG believes that it is NOT possible to isolate a review of Competition Policy from Sectoral Reviews. The Competition Policy Review must consider the issues identified in sectoral reviews. Whilst this may give rise to some inconvenient truths and undermine some of their recommendations the impact of these reviews is likely to be enhanced when exposed to such scrutiny. It will ensure that the so-called *"age of entitlement"* is put to bed.

The financial system is a prime example of each of the issues above and there is little to suggest that the *Financial Systems Inquiry* will address them. To date submissions to that Inquiry by industry participants indicates that these critical systemic issues will be ignored or the systemic issues will be exacerbated.

Accordingly NBG believes that the Competition Policy Review must address the appropriate framework to deliver competition irrespective of the outcomes of any specific sectoral review.

Further it should provide the competition framework against which recommendations from a sectoral review are tested before acceptance. This will ensure the impacts of any Sectoral review deliver wider economic benefits to the Australian economy not just to the specific industry participants.

The Payments Industry – An Example of Flawed Sectoral Regulatory arrangements.

The Banking Sector argued post Wallis that it required an industry specific regulator that focused on the time critical payment systems issues necessary to balance the wider banking system. Logically this lay alongside the RBA's central banking function. The Government's response was legislation that created within the Reserve Bank the Payment Systems Board (PSB). Further the legislative base was designed to apply economic regulation to the Payment System including access arrangements and designation of payment systems that is set out in the Payment Systems (Regulation) Act 1998.

Government left the wider issues of economic regulation of the Payment System to the ACCC as they related to Competition, Mergers and Acquisition. Unfortunately Government failed to address the mechanisms by which the ACCC and the PSB would work together. This contrasted with its approach in energy markets and networks as well as telecommunications. With two economic regulators responsible for the conduct of the Payment System the division of policy responsibilities between the two regulatory bodies was left to the Regulators as detailed in the 1998 Memorandum of Understanding (MOU) between the PSB and the ACCC.

At present the links between the RBA and the ACCC as competition regulator are weak at best. Aside from the 1998 Memorandum of Understanding between the RBA and the ACCC; the only formal link between the two regulators is that the Governor of the RBA and the Chairman of the ACCC meet at least once a year to discuss issues of mutual interest in the payments system[1]. A program of annual occasional meetings is inadequate mechanism to address wider issues associated rapidly evolving electronic payments systems in Australia particularly as they impact on consumers and competition.

Similarly having consumer issues in payments and credit spread across a range of regulators with no one body charged with the responsibility of delivering both consumer protection and economic regulation. A problem made more complex by specifically excluding the ACCC from the area.

[1] http://www.rba.gov.au/payments-system/policy-framework/

Different Regulatory Frameworks and Approaches to Regulation

The problems of ascribing sectoral regulators with competition responsibilities are further exacerbated because the different regulators pursue widely differing approaches to the task.[2] In part legislative prescription arising form sectoral lobbying drives this. The absence of an integrated or agreed approach to considering policy and regulation across Government also contributes.

Relying on sectoral regulators to deliver competitive outcomes designed to facilitate productivity places a great reliance on the central agencies of Government to deliver a coherent approach. Whilst there is the potential for more coordination when say Treasury assumes the core responsibilities and it plays a strong role in directing agencies it becomes more fragmented when:

1. The Independence of the regulator would be trammeled by such actions; or
2. Responsibility is split across portfolios and Departments outside the central economic portfolios are also involved (e.g. Attorney Generals).
3. The Industry Regulator is a State based regulator. Then either State rights are threatened, we see the emergence of 8 different approaches to regulation and ultimately we have a COAG program to try to align the wider national interest with state based sectional desires.

The solution appears to lie in having one central economic regulator responsible to the Treasurer and leaving industry regulators to focus on appropriate specialist industry standards and consumer issues. These can be either at the level of either the State or the Commonwealth but a national approach to economic regulation is essential.

Regulatory models contribute to a loss of Productivity

Economic Regulators operate within an analytic framework underpinned by a rigor and discipline founded in the theory associated with industrial organisation, and the economics of the firm. To this is added an overlay of a legal framework to facilitate enforcement and compliance with the determinations of the regulator or the operation of the market.

Such regulation may be contrasted to "process regulation" which characterises much of the regulation of the Australian financial services sector as found in the regulatory models of ASIC and APRA. Similarly much State based regulation is focused on "standards" and "process" and not driven by delivering efficient economic outcomes. These are "compliance" models with a

[2] Because the Payments Systems Board as a industry regulator operates from its traditional banking constituency with needs for systems integration and cooperation to ensure integrity it appears to assume that the norm for parties in a competitive market will be to develop the appropriate regulatory structures and rules and bring them as consent applications to the PSB. Further it has fostered bodies "consultative" bodies such as EPAL and APCA comprising only the established majors in the industry. These qangos appear to operate absent of any formal regulatory oversight the end effect of which is regulatory capture.

legalistic and administrative law underpinning. Accordingly it is little wonder that productivity and economic benefits of regulation are absent form their perspective of regulation.

Arguably these "process regulators" should obtain the clearance of the economic regulator to their initiatives. This may avoid "crowding out" elements emerging from their "process regulation" as has been evidence in may of the reforms with respect to Financial Planning and Financial Services undertaken by ASIC in the past 13 years.[3]

Accordingly developing a Competition policy framework against which any Government tests recommendations from any industry regulator review would assist economic regulation and competition. Whilst the "Competition Payments" arrangements served some of that purpose an observer could conclude that some Governments signed on to the arrangements as it served their purposes but signed off particularly when under sectoral pressure.

The Productivity Drivers in the 1990's lessons from that period for the current review

As the Review discussion paper highlights, and various Productivity Commission studies have flagged, the golden age of productivity reform occurred during 1990's. In fact the two industries responsible for delivering much of the productivity in that period were energy and telecommunications. Reform in these was driven by Government reform agendas. The greatest gains during this period being in the Electricity Supply Industry in particular the reforms emanating from the Victorian Government's industry restructuring and privatization program[4].

What was common to both industries was a policy commitment by Governments to disaggregation, restructuring and a reward system for the State owners of the assets to pursue reform either in the form of competition payments or proceeds from privatization.

Usefully Government resisted attempts by some interested parties to resort to separate sectoral regulators and instead bolstered the economic regulator providing it with the dual functions of industry and competition regulator. Accordingly the prevailing frameworks of analysis are founded on economic regulation designed to engender competition.

In contrast the economic regulator when dealing with the private sector neither it nor the courts have any powers to effect structural reforms. Clearly one does not wish to arm the economic regulator with the powers of a central planner. But it is clear that the Courts need to have available to them the ability to enforce disaggregation particularly as part of a penalty regime in prosecutions for conduct under Section 46 and misuse of market power. This would ensure that the circumstances that gave rise to the behaviour would not be repeated. It would act as a red flag for businesses when contemplating certain business strategies. It avoid the issue that the Victorian Taxi inquiry observed that despite a $14m fine imposed on Cabcharge Australia

[3] Similar "Crowding Out" effets can be observed in many occupational and industry regulatory regiemes operating at both State and Commonwealth level. As the review's report indicates Taxi Regulations are a prim example of such outcomes.

[4] From some Productivity Commission studies it appears that absent the gains from the reforms of this one industry then Hilmer may not have delivered productivity greater than the long terms trends.

Limited it had not altered the structures in the industry. Divesture of the payment system from its other corporate functions would have altered the industry and avoided another layer of state regulations.[5]

Extension of divesture and restructuring powers to the criminal prosecution powers under the CCA would facilitate competitive outcomes when fines alone are ineffective. The ACCC and the Courts have existing powers for divesture in the mergers process. The evidence is that these have not been abused given the balances inherent in the system.

If, as it appears industry and structural reform were the key precursors to productivity gains then the lessons from that are that it is necessary to put in place the legislative arrangements that enable similar Courts to deliver comparable outcomes where abuse of Section 46 and the misuse of market power is proven.

Extension of divesture and restructuring powers to cover actions under Section 46 and misuse of market power would be an effective mechanism to altering behaviour and delivering structural reforms at both an industry and business level.

In Summary:

1. *NBG believes that it is NOT possible to isolate a review of Competition Policy from Sectoral Reviews. The Competition policy review must consider the issues identified in sectoral reviews and whilst this may give rise to some inconvenient truths and undermine some of their recommendations the impact of these reviews is likely to be enhanced when exposed to such scrutiny.*
2. *The Competition Inquiry needs to consider:*
    a. *The merits of relying on industry regulators for competition reform and whether this can result in suboptimal policy outcomes.*
    b. *The problems of regulatory capture that occur when reliance is placed on industry regulators to deliver competition. There are good examples of this occurring at both State and Commonwealth level where industry regulators have been entrusted with regulation outcomes or consumer protection.*
    c. *The potential for gaps to emerge when economic regulatory functions for an industry is split across several agencies rather than relying on a single competition regulator.*
3. *NBG believes that the Competition Policy Review must address the appropriate frameworks to deliver competition irrespective of the outcomes of any specific sectoral review. Leaving competition issues in an industry to ad hoc informal annual discussions to regulatory chairman, as occurs between the PSB and ACCC is a weak regulatory arrangement.*
4. *The Competition Review could provide a framework against sectoral reviews can tests recommendations for their competition effects before they are accepted.*

[5] In the absence of effective industry reform and in absence of intervention by the Payment Systems Board to impose competitive industry arrangements State based regulators have resorted to price cap regulation.

5. *A common framework against which to test the competition impacts of sectoral reforms will ensure the impacts of any Sectoral review will deliver wider economic benefits to the Australian economy not just to the specific industry participants. The potential for "crowding out" effects in the actions of industry regulators needs to be given special attention at both State and Commonwealth level.*
6. *There should be one economic regulator responsible to the Treasurer leaving industry regulators to focus on appropriate specialist industry standards and consumer issues. These can be either at the level of either the State or the Commonwealth but a national approach to economic regulation is essential.*
7. *Examination by the Review of extending divesture and restructuring powers to cover prosecutions for offences under Section 46 and misuse of market power would be an effective mechanism to altering behaviour and delivering structural reforms at both an industry and business level.*

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