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Dear Professor Harper,

Ian

SUBMISSION TO COMPETITION POLICY REVIEW

We welcome this review and the opportunity to respond to the *Competition Policy Review* Issues Paper. The National Competition Policy, which was established in the 1990s, instigated a range of economic reforms that delivered higher productivity throughout the Australian economy. More recently, however, productivity growth has slowed. A new round of economic reform would drive productivity improvements across Australia.

IPART is the independent economic regulator in New South Wales. We also serve as the NSW Government's economic advisor and policy think tank. Our role makes us well-placed to comment on aspects of competition policy.

We consider there is scope to improve outcomes for customers by opening markets to competition, allowing competition to drive costs lower and deliver 'better' products and services for customers.

Key industries in our bailiwick that could deliver benefits from competition-based reform include water and public transport including taxis. We consider that markets should be opened to competition, as customers are the most effective regulators. This should be the default position. However, in a limited number of cases it might not be possible, and in such cases competitive procurement can be used to drive efficiency gains.

We recognise the importance of your review and would like to offer our assistance to your Panel and Secretariat. Please contact Ms Anna Brakey on 02 9290 8438 if you have any questions.

Yours sincerely



Peter J. Boxall AO
Chairman



Independent Pricing and Regulatory Tribunal

Opportunities for further reform

IPART's submission to the Competition Policy Review Issues Paper

June 2014

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1 Executive summary

IPART is the independent economic regulator in New South Wales. We also serve as the NSW Government's economic advisor and policy think tank. Our role makes us well-placed to comment on aspects of competition policy.

The National Competition Policy, which was established in the 1990s, instigated a range of economic reforms that delivered higher productivity throughout the Australian economy. In 2007, the Productivity Commission estimated that after a period of adjustment, the competition and regulatory reform streams could result in a 2% increase in GDP.¹

More recently, however, productivity growth has slowed. A new round of economic reform would drive productivity improvements across Australia as competitive pressures deliver efficiency gains. We consider there are some key areas for reform, and welcome this review and the opportunity to respond to the *Competition Policy Review Issues Paper*.

Competitive markets deliver goods and services that customers want at prices that reflect efficient cost of production. Competitive markets are responsive to changes in consumer preferences and drive innovations that lead to more choice and better value for customers.

Customers have a crucial role in competitive markets. For example, they choose the products or services they want, the level of quality they expect for a given price and at what price levels they would switch to a different product. Suppliers strive to win customers by lowering costs or providing a 'better' product. Competitive markets also drive innovations, which are crucial to achieving dynamic efficiency.

While regulation can, up to a certain point, mimic a workably competitive market, introducing competition will almost certainly achieve more efficient outcomes. Economic regulation is required to address problems that arise in uncompetitive markets. While regulation represents an improvement over an uncompetitive market, a better solution is to remove barriers to entry and restructure the market in order to promote more competition and reduce the need for economic regulation.

Opening the market to competition (competition in the market or contestability) is preferable to undertaking a competitive procurement process (competition for the market), but both can deliver benefits. To illustrate the difference, in electricity, the retail market was made fully **contestable**. Private firms entered the market to compete for retail customers. In NSW, these private firms competed with the government-owned retailers until their sale in 2010. By

¹ Productivity Commission media release, *Potential Benefits of the National Reform Agenda*, 28 February 2007.

contrast, in NSW, certain bus routes are provided by the private sector under contract to the government for designated areas. These contracts have been subject to a **competitive procurement process**.²

Introducing competition, where it is possible, is preferable to competitive procurement. However, where full competition is not feasible, benefits can be gained from competitive procurement of services due to competitive pressure arising from the tendering process. Competitive procurement driving efficiencies on the supply-side of government services should not however be viewed as a substitute for competition reform. It is a means of driving efficiency in a non-contestable market.

Our submission focuses on 2 broad themes:

- ▼ **Economic reforms** that can stimulate competition, including in the water and transport industries.
- ▼ **The role and governance** of regulators.

In terms of the **economic reforms** to support competition, we consider that competition should be introduced wherever feasible. Further, we have identified that one of the major impediments to competition is that some government services are currently funded using implicit community service obligation payments (CSO) via cross-subsidies for services which would otherwise be uneconomical to provide. Changing the current funding model to one that uses explicit CSO recognition and tendering would allow private sector firms to compete on a level playing field. Using explicit CSOs would also facilitate the removal of postage stamp pricing regimes, applied for instance in the NSW urban water industry.

We have identified a number of **governance** issues related to economic regulators. In some areas, there are too many regulators dealing with one business or industry. For example, the majority of NSW State Water's assets are regulated by the ACCC. IPART regulates a small part of the infrastructure, which adds to costs.

We consider that our recommendations can be applied nationally to reduce regulatory uncertainty and increase competition.

² IPART, *Maximum fares for metropolitan and outer metropolitan buses from January 2014 – Final Report*, November 2013, p 6.

The key message of our submission is that production and living standards would increase if the following were adopted:

- ▼ existing reform recommendations in the taxi industry
- ▼ contestability and/or competitive procurement in the provision of public transport
- ▼ gradual removal of postage stamp pricing for water (where it exists) with more cost reflective pricing for water, and competition introduced in the upstream and downstream water markets
- ▼ a framework similar to IPART's regulation review framework to assess licences to identify impediments to competition
- ▼ regulatory requirements streamlined across local councils relating to land use
- ▼ the application of the *Corporations Act 2001* (Cth) (Corporations Act) to SOCs, where they are not already subject to these provisions
- ▼ fees for government services to reflect efficient costs
- ▼ the recommendations from the PC's report on the National Access Regime
- ▼ economic regulators to periodically review and report against the competition reform priority areas that are identified in this competition policy review.

2 Competition policy

What should be the priorities for a competition policy reform agenda to ensure that efficient businesses, large or small, can compete effectively and drive growth in productivity and living standards?

We consider that governments should address market failures and remove government-imposed barriers to entry, including by defining and transparently funding community service obligations (CSOs) and making them available to all providers (including the private sector) where there is competition for the provision of the relevant service.

Regulation should not be a substitute for competition

Competitive markets deliver better outcomes for customers than regulated markets. In a competitive market, suppliers strive to win customers by lowering costs or providing a 'better' product, in terms of quality, price and timeliness. Where the market is not open to competition, economic regulation can restrict the power of suppliers by limiting their ability to extract monopoly rents from customers, and drive ongoing productive efficiency. However, it is difficult for regulators to achieve the allocative and dynamic efficiency and innovation of competitive markets.

We consider that regulators and policy makers should continue to implement reforms that introduce more competition by addressing market failures and identifying government imposed barriers to entry.

Current funding models are an impediment to competition

We consider the current funding model for some government-provided services to be a barrier to competition. In particular, we identify the current CSO arrangement as an area for improvement.

CSOs are non-commercial services that the government directs suppliers to deliver on its behalf. In many cases, governments direct their agencies or state-owned businesses to deliver CSOs. These providers are often required to absorb the cost of CSOs into their operating budgets, often involving non-transparent internal cross-subsidies.

We have identified some significant shortcomings of this situation. Firstly, it is unclear how much the CSOs cost government agencies to deliver. Secondly, because CSOs are not directly funded by government, agencies have to overcharge for some of their other services in order to cover the costs of their CSOs. That is, agencies are required to either cross-subsidise their commercial and non-commercial services, or to request greater government funding (or lower dividends). This in turn can lead to the restriction of competition in otherwise contestable areas so the internal cross-subsidies can be maintained. It also creates economic distortions in these and other related markets. Thirdly, it is uncompetitive because alternative suppliers are unable to compete to deliver these services, as they are unable to access CSO funding.

We recommend that CSOs be clearly defined and funded and available to all suppliers in the market.

3 Regulatory impediments to competition

Are there unwarranted regulatory impediments to competition in any sector in Australia that should be removed or altered?

Are there occupational-based restrictions, or restrictions on when and how services can be provided, that have an unduly adverse impact on competition? Can the objectives of these restrictions be achieved in a manner more conducive to competition?

We have addressed these 2 questions together based on our experience in reviewing taxi fares and the number of new annual Sydney taxi licences, public transport, retail gas pricing and regulation review.

The taxi industry needs further reform

The regulatory framework for taxi licensing in NSW was amended in 2009 in order to reduce barriers to entry and encourage competition. Within the new framework, IPART has been asked to review and make recommendations on the number of new annual Sydney taxi licences in 2013 and 2014. We consider that this regulatory framework could be enhanced by an independent regulator having the power to make determinations (rather than recommendations). Licence reforms in the taxi industry should also be extended to country areas.

Taxis must have a licence to operate in NSW. In 2009, there were around 5200 taxi licences, and average licence values had increased by around 50% to \$390,000 in 10 years.³ Many licences were being operated by persons other than the owner, leasing out for around \$26,000 (excluding GST) per year in 2009.⁴ While new 50-year ordinary licences and 6-year short term licences could be purchased from the Government, the cost was a significant barrier to entry and the take up of new licences was very low.⁵

³ PricewaterhouseCoopers, *Benefit/Cost Assessment of Options for Reform of Taxi Licensing, Final Report*, September 2005, p 18, Transport for NSW, *Taxi Licence Average Prices*, https://appln.transport.nsw.gov.au/mint/vap/vap_summary.php, accessed 21 May 2014.

⁴ IPART, Annual taxi licence release for Sydney 2013/14 – Final Report, February 2013, p 2.

⁵ Ordinary licences were sold at the market price of perpetual licences. Short-term licences were set at an annual fee of 14% of the market rate of an ordinary licences. This was significantly higher than the lease yield of perpetual and ordinary licences of around 7% to 9%. PricewaterhouseCoopers, op. cit., pp 15-16.

Ordinary, perpetual, and short term licences for Sydney are no longer issued by Transport for NSW. Instead, amendments to the *Passenger Transport Act 1990* (NSW) in 2009 require Transport for NSW to determine the number of additional 'annual' licences that should be tendered in Sydney each year, and these are tendered for an annual fixed fee. These licences are renewable for up to 10 years.

Since 2009, the net growth in Sydney in new licences has been 13%.⁶ The amendments have the potential to create benefits for passengers by reducing waiting times, and reducing fares. However, between 15% and 20% of taxi fares are still being transferred to licence leaseholders as economic rent.

We were given terms of reference from Transport for NSW to recommend the number of new annual licences for 2013 and 2014. All of the considerations in the terms of reference supported the release of more licences, subject to the requirement to consider the need to avoid unreasonable impacts on licence holders.⁷

We considered that a 25% reduction in licence lease values over 5 years was not unreasonable, and our recommendations on licence numbers and fares were made in this context.⁸

In other areas such as water and electricity, the role of an independent regulator making determinations enhances the regulatory framework. Importantly, the passengers who stand to benefit from reform include a significant number of lower income earners, many of whom have limited transport options due to age or disability.

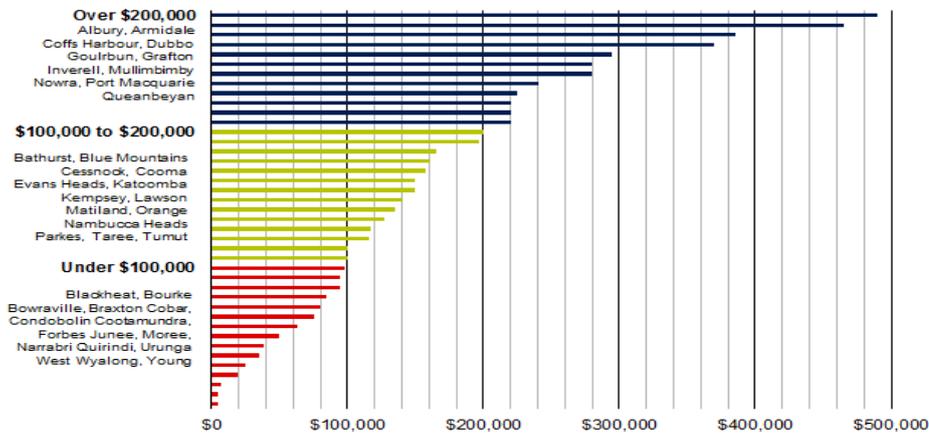
Further, taxi licence reform could be pursued in country areas. While wheelchair accessible taxi licences are available on request (for free) in country areas, in some regions significant economic rent persists for ordinary licences (Figure 3.1)

⁶ From 5220 to 5900 licences, comprising of around 270 new unrestricted licences, 300 new peak availability licences that cannot operate between 5 am and midday, and 100 wheelchair accessible taxis.

⁷ IPART, *Review of maximum taxi fares and review of annual Sydney licences from July 2014 – Draft Report*, December 2013, p 8.

⁸ IPART, *Review of maximum taxi fares and review of annual Sydney licences from July 2014 – Final Report*, March 2014, p 3.

Figure 3.1 Average licence transfer values in various NSW towns (April 2011 to December 2013)



Note: The towns listed for each group are in alphabetical order, which does not correspond with series order.

Data source: Transport for NSW information return.

Regulation in the taxi industry prevents market entry

NSW has adopted a model of co-regulation whereby taxi networks enforce taxi vehicle and driver standards. As part of this model, all taxis must belong to a network⁹, and taxi networks must provide 24 hour booking network to all areas, security monitoring services and lost property services.¹⁰ There is limited price innovation and competition between network services. For example, networks tend to charge a monthly fee, regardless of how many jobs are provided by the booking services.

With the emergence of apps such as GoCatch, ingogo, and Uber taxi, there has been some innovation in booking services. This has resulted in improved services from the traditional networks, including better information for customers about whether a taxi has accepted a booking, and the location of the booked taxi. Some of these apps are also competing on pricing of the booking and payment components of the taxi fare (fares paid electronically in NSW have typically attracted a 10% surcharge, although the government has proposed to cap the surcharge at 5%¹¹).

The NSW government recently announced that it would regulate and encourage the creation and use of innovative new mobile phone booking apps. Again, regulation should be outcome-focussed, implemented by an independent third

⁹ *Passenger Transport Act 1990*, Section 30(1).

¹⁰ *Passenger Transport Regulation 2007*, Sections 174, 175 and 178.

¹¹ Media Release, Transport for NSW, *Safer, smarter, cheaper and more reliable: customers win from NSW Government taxi reforms*, 8 April 2014.

party and should not inhibit innovation, competition or new entrants to the market.

Increasing competition in passenger vehicle point to point services with the introduction of rideshare apps would allow a lower cost option for passengers, and has the potential to drive service improvements. Regulation relating to passenger safety requirements for these services should be by an independent body and outcome-focussed to ensure they remain relevant and do not unduly inhibit innovation and competition.

Further reforms to the urban bus sector are required

Currently most passenger transport services operated by private operators must have a contract with the NSW Government. These contracts provide for exclusive provision of services within each region in exchange for a contract payment. As contracts are renewed they are increasingly being opened up to competitive tendering.¹² The NSW Government spends over \$1 billion dollars a year on contract payments to bus operators across the state.¹³

Under this arrangement, once the contract has been awarded no other bus services can operate competing routes in the area if those routes are less than 40km. Routes greater than 40km are not subject to contract arrangements. Competition for these longer routes does occur and in some cases these longer routes replicate the types of service provided by contract providers. For example, there is a service in Sydney, the 'BulletBus' that operates an unsubsidised commuter route which is just over 40km with a fare well above the equivalent bus fare for a contracted service.¹⁴

While the NSW Government has adopted competitive procurement in metropolitan areas, there may be scope to extend this to outside Sydney. There may also be scope to make bus service contracts non-exclusive for routes less than 40km in regions that have a significant number of fare-paying passengers.

The gas retail market should be deregulated

We support deregulating the gas retail market in NSW. As part of our reviews of NSW retail electricity and gas prices in 2013, we assessed the effectiveness of competition in the NSW energy retail markets. We found that competition was protecting customers, as well as offering more choices and better price and service outcomes.¹⁵

¹² In Sydney, regions that have not been put out to tender are subject to the threat of the Government doing so.

¹³ Information provided to IPART by Transport NSW, August 2013.

¹⁴ BulletBus, <http://www.bulletbus.com.au/index.html>, accessed 10 June 2014.

¹⁵ IPART, *Review of regulated retail prices and charges for gas from 1 July 2013 to 30 June 2016 – Final Report*, June 2013, p 6.

In April 2014, the NSW Government announced that retail electricity prices will be fully deregulated from 1 July 2014.¹⁶ We also recommend that the NSW gas retail market is deregulated because 75% of customers in NSW have already moved from regulated gas prices to market contracts.¹⁷ We consider that competition in this market is now effective enough to provide sufficient protection to customers, as well as offering more choices and better price and service outcomes.

We also consider that a competitive market is best-placed to manage the uncertainties that are emerging in the wholesale gas market, as the east coast gas market begins to export to the world market. Effective retail competition – where retailers strive to offer customers products and services they value at competitive prices – is the best way to ensure that gas prices are driven towards the efficient cost of supply and that ongoing innovation occurs. In short, a well-functioning competitive market is in the long-term interests of customers.

Red tape is a barrier to competition

As part of our regulatory review function, we have developed a licensing framework to assess the red tape burden of existing and proposed licences.¹⁸ This framework can be used to assess red tape across the wider economy.

The licensing framework requires a regulator to justify that government action is required to address a specific problem or risk and that licensing is the best response. Application of the licensing framework can ensure that licensing regimes only restrict competition where it can be demonstrated that they are the best response to achieve the policy objectives.

Where a licence is necessary, the framework also requires an assessment of whether the licence is well-designed. That is, whether the various aspects of the licensing regime that may restrict competition are the minimum necessary. This requires a regulator to take into account how the objectives of a licence relate to its coverage, duration, reporting requirements, fees and charges and conduct rules.

We consider that this framework could be used by other NSW regulators and in other jurisdictions to limit the barriers to competition arising from licensing.

¹⁶ <http://www.resourcesandenergy.nsw.gov.au/energy-consumers/energy-sources/electricity/removal-of-electricity-price-regulation>, accessed 29 May 2014.

¹⁷ IPART, *Changes in regulated retail gas prices from 1 July 2014 - Final Report*, June 2014.

¹⁸ PricewaterhouseCoopers, *A best practice approach to designing and reviewing licensing schemes – Independent Pricing and Regulatory Tribunal*, available from our website at http://www.ipart.nsw.gov.au/Home/Industries/Regulation_Review/Reviews/Licence_Design/Licence_Rationale_and_Design, accessed 20 May 2014.

Are there planning, zoning or other land development regulatory restrictions that exert an adverse impact on competition? Can the objectives of these restrictions be achieved in a manner more conducive to competition?

Regulatory requirements relating to land use can be streamlined

We consider that there is significant scope to streamline and simplify regulatory requirements relating to land use and the development process in NSW, with beneficial effects for competition. This section outlines our view based on our experience with local government, including setting the rate peg for the annual change in council rates.

In our recent review of local government compliance and enforcement regulation, business stakeholders raised a number of concerns about delays, inconsistencies, restrictions and onerous requirements in the current planning and development assessment system. Further, concerns were raised about unnecessary complexities and restrictions in the zoning system.¹⁹

Many of these concerns relate to the planning system process, resulting in unnecessary costs for developers and businesses. In general, larger developers are better able to absorb costs during market downturns, and more able to negotiate beneficial agreements for infrastructure provision than smaller developers. A potential impact of variable and uncertain planning-related costs and requirements is a reduced ability for smaller operators to remain competitive which might affect the structure of the development industry and restrict the products available.²⁰

The concerns of stakeholders specific to zoning and land development relate to:

- ▼ the restrictive nature of some council zoning definitions (eg, heritage areas which disallow code compliant or exempt development)
- ▼ the lack of suitably zoned land for large commercial or retail developments
- ▼ the difficulty in getting areas re-zoned for new uses (eg, industrial to commercial to provide for new businesses in gentrified areas).²¹

¹⁹ IPART, *Local Government Compliance and Enforcement – Draft Report*, Chapter 7 - Planning (IPART Regulation Review Report), May 2014, p 179.

²⁰ Australian Housing and Urban Research Institute (AHURI), UNSW-UWS Research Centre, *Counting the costs: planning requirements, infrastructure contributions and residential development in Australia*, Final Report No. 140, November 2009, p 13.

²¹ IPART Regulation Review Report, Section 7.6, p 197.

Among the NSW Government's recent proposals for planning reforms are a number of reforms to address procedural and zoning-related issues. If implemented, these reforms should ultimately help to encourage more development activity and facilitate competition.²² In particular, we recommend:

- ▼ **more simplified and accommodating zoning requirements** in Local Environment Plans (LEPs) consistent with easier rezoning processes and more suitably zoned land for commercial or retail developments
- ▼ **more streamlined development assessment** to reduce delays and the cost impacts on business
- ▼ **greater standardisation in council planning policies and requirements**, including more standardised development consent conditions, to reduce uncertainty, cost and investment risk for business in the development process.²³

We also recommend the establishment of a **Planning Partnership Model** between the NSW planning agency (now Department of Planning and Environment) and local government to better manage complexities in the system, to facilitate a more streamlined and coordinated approach, and to increase council capacity and capability in planning regulation. This recommended model is based on a proven partnership model between the NSW Food Authority and local government in NSW.²⁴

We also support **contestability in infrastructure provision**. We therefore support the NSW Government's proposed reforms to the infrastructure contributions framework to introduce contestability assessments for the provision of infrastructure in plans at an earlier stage in the planning process.²⁵ These assessments should encourage the private sector to design, deliver and operate infrastructure solutions for new greenfield developments or urban renewal precincts.²⁶

²² NSW Government, *A New Planning System for NSW – White Paper*, April 2013 (NSW Planning White Paper).

²³ NSW Planning White Paper, pp 23-31, 59-149.

²⁴ IPART Regulation Review Report, pp 32-62.

²⁵ NSW Planning White Paper, pp 160-161.

²⁶ Ibid.

Lastly, we consider that **works-in-kind (WIK) agreements**²⁷ can provide an efficient and flexible mechanism for the provision of infrastructure. However, regulatory requirements should ensure that agreements are transparent, so that developers and ratepayers can assess if agreements are consistent and fair. Currently, some councils do not publish their policies or approaches to such agreements but negotiate with developers on a case-by-case basis. This approach can make it particularly difficult for smaller developers to negotiate such agreements and may be counterproductive for competition. We support the NSW Government's current work to develop standard templates and guidelines for such planning agreements.²⁸

Smaller developers tend to be less able to absorb unnecessary costs in planning regulation than larger developers. The proposed planning reforms aim to address procedural concerns (eg, in the development assessment and works-in-kind agreement processes) and would increase the ability for smaller operators to remain competitive. Increased contestability in infrastructure provision would increase access to the private sector to design, deliver and operate infrastructure solutions for new greenfield developments or urban renewal.

²⁷ A developer may seek to construct public infrastructure and/or dedicate land identified in a Section 94 Contributions plan in lieu of making a monetary contribution. This arrangement is governed by a works-in-kind agreement, which is a legally binding contract entered into by the council, developer and landowner prior to commencing work.

²⁸ This work is currently being progressed by the NSW Department of Planning and Environment, in consultation with a number of key stakeholders as part of the Government's broader planning reform agenda.

4 Government-provided goods and services and competitive neutrality

Is there a need for further competition-related reform in infrastructure sectors with a history of heavy government involvement (such as the water, energy and transport sectors)?

We consider that there is significant scope to reform the water sector. We also have identified reform opportunities in the transport sector.

Competition in the urban water sector should be promoted

Competition for the market is where firms compete for the right to serve a particular market or provide specific services. Competitive procurement is a form of competition for the market. To maximise the scope for innovation and efficiency, competitive tendering processes (and other processes for facilitating competition for the market) should be outcomes-focused, rather than overly prescriptive.

Competition for the market can range from an incumbent water utility's competitive procurement of specific services or assets, to competition to be the water utility for a specific geographic area (eg, in a new development area). Through removal of impediments to competition, as well as the more expansive application of competitive procurement practices, we consider there is scope to promote greater levels of competition for water markets (and hence enhanced efficiency and innovation).

Public-private partnerships, build-own-operate contracts and joint ventures are relatively well established in Australian markets. In Sydney, there is currently a privately owned desalination plant and privately owned water treatment facilities. These privately owned facilities have been built through competitive tendering processes.

In NSW, under the *Water Industry Competition Act 2006* (NSW) (WICA) framework, there has been increased private interest in developing, owning and operating the water and wastewater infrastructure for entire communities. However, to date, private sector schemes have been relatively small and/or have served developments beyond the urban fringe (and beyond the immediate servicing plans of the large incumbent public water utility).

There are a number of impediments to more extensive competition for water markets, which could be removed. These include, for example:

- ▼ The ability of large, government owned incumbent water utilities to cross-subsidise their provision of services to new development areas. Large incumbents are better positioned than smaller suppliers to run the necessary cross-subsidies, such as postage stamp pricing.
- ▼ The tendency for government strategic land-use planners to rely on information from the incumbent public water utility to inform their decisions (eg, in relation to the location and sequencing of land release), rather than also seek information or expressions of interest from the market.
- ▼ Inconsistent rights or regulatory requirements of existing state-owned utilities relative to potential new entrants.

In Europe and South America, concessions are a popular method of creating competition for the market. However, outside of South Australia, they have been rarely used in Australia. Concessions allow the private sector to bid to operate water and wastewater systems for extended periods of 10 to 30 years. Concessions involve competitive tendering for the operation and provision of services. This forces a utility to seek efficiency gains to outbid competitors, creating competitive pressures in monopoly markets.²⁹ Whole of system concessions may prove particularly valuable for small water utilities, such as the water and wastewater systems operated by local councils in NSW.

We also consider there should be competition for the market for providing non-commercial services or community service obligations related to water (eg, universal service obligations). That is, governments should seek to competitively procure these services by calling for bids or expressions of interest from the market, rather than requiring (or granting the right to) public water utilities to provide these services. In such circumstances, the public water utility could be a bidder or a public sector comparator (and default supplier).

Promote competition in upstream and downstream water markets

Water and wastewater distribution networks are generally considered to be natural monopoly assets. However, services ‘upstream’ and ‘downstream’ of these natural monopoly assets are potentially competitive. These potentially competitive services include bulk water supply, water treatment, wastewater treatment and disposal, and retail.

²⁹ The existing utilities are able to make competitive bids and, if successful, should be held to the same conditions as private sector utilities.

In NSW, WICA provides an access regime for Greater Sydney and Greater Newcastle's water and wastewater distribution systems. To date, there have not been any access seekers under WICA,³⁰ and only one draft access undertaking³¹. There may be a number of factors that are preventing companies seeking access:

- ▼ uncertainty relating to conditions of access, including access prices
- ▼ the limited scope for competition in bulk water supply in Sydney and the Hunter region for the foreseeable future (given factors such as the current water demand/supply balance, the dominance of the established dams, and the high costs of pumping water from other locations)
- ▼ a provision currently in WICA that requires new entrants to obtain water from a source other than a public water utility³²
- ▼ the incumbent's ownership of, or exclusive supply contracts with, large water filtration and wastewater treatment plants
- ▼ costs of entry (including costs of obtaining regulatory approvals and access or wholesale agreements), combined with a relatively small proportion of the total water bill comprising retail operating costs and margin
- ▼ the vertical integration of Sydney Water³³ and Hunter Water.

In relation to the last point above, a vertically integrated water utility makes it difficult for another business to enter the market. A business that seeks to enter a vertically integrated business's market will often need to negotiate access to the monopoly part of the supply chain (the distribution networks), purchase of filtration services and, in some cases, the purchase of bulk water, with its direct competitor. For access purposes, it may be required to reveal to its competitor its customers and their demand.³⁴ This creates an uneven relationship between competitors, with strong competitive advantages for the vertically integrated incumbent. Furthermore, the vertically integrated business has no incentive to seek access agreements, as these may lead to decreased market share in downstream markets and associated profits.

Further vertical separation in the water industry would likely increase the potential for competition upstream and downstream of distribution infrastructure, particularly in retailing.

³⁰ Services Sydney sought access to 3 of Sydney Water's sewerage networks. Access to these sewerage networks was declared under the (then) Trade Practices Act, however following the Australian Competition Tribunal's determination that prices should be set at retail minus avoidable costs, Services Sydney did not enter an access agreement with Sydney Water. See http://ncc.gov.au/application/services_sydney_pty_ltd for further information.

³¹ Sydney Water submitted an access undertaking to IPART in January 2012. IPART proposed a series of recommendations to improve the undertaking and reduce the barriers to entry. The access undertaking has not yet been finalised.

³² WICA, Section 10(4)(d).

³³ Sydney Water has had some vertical separation with the establishment of the Sydney Catchment Authority.

³⁴ Such information is required for the purpose of managing the supply of water within the distribution system.

We note that alternatives to vertical separation can also be considered to enhance competition. In 2008, retail competition was introduced into the non-residential Scottish water market. Since then, more than 60% of businesses have negotiated better prices or level of service. Notably, the Scottish reforms did not vertically separate businesses; rather it instituted legal separation of the retail business from Scottish Water.³⁵

Postage stamp pricing for water is a major barrier to competition

Postage stamp pricing reflects the average cost of servicing a given area (eg, Sydney Water's area of operations). The National Water Initiative (NWI) pricing principles allow postage stamp pricing, but state a preference for differentiated prices in specific areas.³⁶ However, postage stamp pricing remains NSW government policy.³⁷

Postage stamp pricing impedes competitive entry into the water and sewerage markets. Most growth areas are on the urban fringe, which is higher than average cost to service.³⁸ As such, the incumbent business is able to service the growth area at the postage stamp price, using its large customer base to subsidise growth expenditure, while new entrants must recoup all costs through charges to its new customers. This creates a barrier to competitive entry. This issue is exacerbated in the absence of cost-reflective developer charges.³⁹

Postage stamp pricing also distorts location based investment decisions. The postage stamp price removes price signals to customers about the costs of servicing locations. Individual inefficient decisions, such as increasing density in areas that require highly treated river outflows instead of primary treated ocean outflows, will increase the costs of sewerage services to all customers. This creates an element of moral hazard.

³⁵ <http://www.watercommission.co.uk/UserFiles/Documents/Water%20and%20sewerage%20competition%20in%20Scotland.pdf>, accessed 4 June 2014.

³⁶ According to the National Water Initiative's pricing principles, "water charges should be differentiated by the cost of servicing different customers (for example, on the basis of location and service standards) where there are benefits in doing so and where it can be shown that these benefits outweigh the costs of identifying differences and the equity advantages of alternatives." National Water Initiative, *National Water Initiative Pricing Principles*, 2010, p 11.

³⁷ In Hunter Water's area of operations there is location based charging for large non-residential water customers.

³⁸ Most of the remaining growth land requires connection to existing networks, where they will be charged with reference to the postage stamp price for these connections.

³⁹ Developer charges can be designed to capture all costs of servicing a new development, less postage stamp price revenue. They can therefore negate most of this competitive advantage.

Water and sewerage developer charges should be cost reflective

Developer charges ensure that the majority of growth expenditure is paid for by the beneficiaries of the growth. The NSW Planning White Paper⁴⁰ has recommended the introduction of developer contributions for roads, electricity and civic amenities. We consider that developer contributions send valuable price signals to developers. This should lead to more efficient development decisions. They can also be an important complement to postage stamp pricing.

In NSW, the Government directed Sydney Water and Hunter Water in 2008 to cease levying developer charges for water, sewerage and stormwater assets. This removed a signal of the cost of development. This leads to the wider customer base subsidising potentially inefficient growth investments.⁴¹

Additionally, we consider that removing developer charges has created an additional barrier to competitive entry in areas of postage stamp pricing. Without cost-reflective developer charges, the incumbent business can develop an area at little cost to growth customers by increasing the postage stamp price across its customer base.⁴² However, competitors need to finance their entry costs, which they need to recover from growth customers, usually through developer contributions or higher ongoing charges. This creates a competitive advantage for the incumbent.

Water prices do not currently reflect supply and demand conditions

We consider scarcity prices would increase competition in the bulk water market and encourage efficiency when augmenting bulk water supply.

During the drought in the early to mid 2000s, most major cities in Australia imposed water restrictions. Water restrictions are effective tools and are generally supported by the community; however, they are blunt instruments and may create welfare losses relative to efficient scarcity prices.⁴³ Scarcity pricing may be used to ameliorate, if not avoid, water restrictions.

A form of scarcity pricing in the urban water market could result in water prices that better reflect supply and demand conditions. Scarcity pricing could be implemented at the retail level and/or at the bulk water level. At the retail level it would send a scarcity signal directly to customers. This would encourage customers to reduce their discretionary consumption when dam levels are low.

⁴⁰ NSW Planning White Paper, pp 162-170.

⁴¹ We estimate that the average water and sewerage customer in Newcastle pays \$59 per year and Sydney pays \$28 per year towards growth infrastructure that would otherwise have been paid by developer charges (\$2013/14).

⁴² Developers still contribute some distribution assets.

⁴³ OECD, *Water Security for Better Lives*, 2013, p 79.

At the bulk water level, it would signal the cost of water to retail businesses. It would help ensure that they purchase water from the least cost combination of supply sources⁴⁴ and create incentives to invest in water conservation measures when efficient. It would also create a price signal to suppliers, and potential suppliers, of bulk water. This would encourage efficient investment in supply augmentations.

We consider that in the short term, scarcity prices would need to be administratively set (this is in contrast, for example, to a market-determined scarcity price that applies in the bulk water market in the Murray Darling Basin, where a price is set by the market through the trade of water entitlements).

By way of example, options for administratively setting scarcity prices include:

- ▼ In conjunction with usage targets at different water storage levels, set prices based on the best estimate of immediate price elasticity. Theoretically, this would reduce consumption to the desired levels, however the wide range of estimates of the price elasticity of demand for water make this unreliable.⁴⁵
- ▼ Recalculate the long run marginal cost of water supply as water storage levels fall. This relies on the assumption that low dam levels accelerate the timing of the next supply augmentation and consequently increase the long run marginal cost.
- ▼ Set the charges to the marginal costs of supplementary supply sources when they are activated. For example, in Sydney as water storages fall the Shoalhaven pumping scheme and the Sydney Desalination Plant would increase charges as they are turned on in accord with their operating rules.⁴⁶

⁴⁴ To the extent possible under operating rules.

⁴⁵ There is no consensus estimate of the price elasticity of water demand. For example, the OECD estimates price elasticity of demand at -0.56 (OECD, *Water Security for Better Lives*, 2013, p 80), while Sydney Water has estimated long run price elasticity of demand at -0.11 (Sydney Water, *The residential price elasticity of demand for water*, February 2011, p 8). Therefore, the potency of scarcity pricing is unknown.

⁴⁶ Under the existing operating rules, Shoalhaven pumping begins when storages fall below 75%, and the desalination plant begins operation when storages fall below 70%. (NSW Government, *2010 Metropolitan Water Plan*, August 2010, pp 7, 24).

The governance and structure of the water industry can be simplified

We consider that competition in the water market is most viable in large cities. The opportunity for horizontal expansion across urban water markets can increase competitive pressure in the market. It improves choice by leading to a greater number of water retailers that might offer different packages to customers. Horizontally integrated businesses can develop economies of scale in some of their operations, such as customer service and IT. Utilities that develop superior processes and technologies will immediately create a driver for efficiency gains elsewhere.

We consider it is important that individual states use competitive pressures to develop superior policies to attract investment in their states. We also consider it important to maintain state-based regulatory regimes, to allow for local environments and regulatory requirements where necessary.

However, within state-based regimes, we also consider it important to develop nationally consistent principles in relation to competition and private sector participation in the water market, similar to the reform of water entitlements from the 2004 National Water Initiative. This could facilitate greater investment and lead to stronger competition in the water industry, without undermining state-based regulatory regimes and the benefits of competition between states. Furthermore, once consistent regulatory frameworks and principles are in place, states should consider reciprocally recognising licences issued under each regime, to facilitate horizontal expansion.

The NSW Water Industry Competition Act (WICA) provides a framework for developing nationally consistent principles. We consider that these key principles include:

- ▼ water licensing for private water utilities should be as simple and standardised as possible, while providing protection for customers, the environment and the broader community
- ▼ key urban water markets should have access regimes
- ▼ there should be clear and consistent dispute resolution processes
- ▼ there should be powers to price regulate monopoly services
- ▼ licenced water utilities should have powers of entry
- ▼ safeguards should be incorporated through auditing water utilities.

WICA has been effective at introducing private sector companies into the water industry and introducing innovative water and wastewater servicing solutions. Nevertheless, there remains scope to amend the regulatory regime and remove impediments to competition in the NSW water industry, which might also be applicable to other jurisdictions.

For instance, the WICA licensing regime for private utilities has been scheme specific, whereas publicly owned water utilities have area based licences. This impedes the ability of private utilities to expand, as they require variations or new licences for every expansion. However, this issue is being considered in the current review of WICA.

WICA has also imposed supply conditions on private water utilities. Section 10(4)(d) of WICA requires that “sufficient quantities of the water supplied by the licensee will have been obtained otherwise than from a public water utility”. This condition was designed to ensure that new entrants contribute to water security. However, we consider that water security can be achieved more efficiently through direct pricing and demand management targets (and that demand management targets are best met through allowing the market to determine the most efficient means).

The WICA access regime allows the Minister to make coverage declarations for the water and wastewater distribution infrastructure services. This compels the owners of the infrastructure to negotiate access. However, WICA excludes filtration and treatment infrastructure. With the existing economies of scale in some of these plants and the exclusive supply contracts with incumbent utilities, the scope for market entry may be severely limited without their inclusion in coverage declarations. New entrants would be required to build infrastructure, which would increase costs and make them less competitive.

Market-based mechanisms can achieve environmental objectives

In NSW, water demand management targets and strategies are determined by government policy.⁴⁷ These include decisions on future supply augmentations and targets relating to water, efficiency savings and recycled water production. We consider that market-based mechanisms are the most efficient means to achieve environmental objectives.

In the NSW energy sector, the Energy Savings Scheme is a market mechanism to meet electricity demand management targets. This provides a model that can be developed for water demand management. Water is a more local good, and therefore water savings could be system specific.

In such a scheme, activities that reduce potable water demand, such as building a recycled water plant or replacing inefficient appliances, would generate water saving certificates. These would be tradeable. Water utilities could achieve their demand management targets⁴⁸ through the purchase, or generation, of water saving certificates. In periods of water restrictions, this scheme could potentially

⁴⁷ Examples include the Lower Hunter Water Plan for the Greater Newcastle region and the Metropolitan Water Plan for the Greater Sydney area.

⁴⁸ Demand management targets could be based on water storage levels, increasing the value of demand management activities during periods of water scarcity.

allow parties to buy water saving certificates to get an exemption from water restrictions, creating a market-based method of opting out of water restrictions.

Similarly, market-based instruments can be effective for environmental regulation. The Hunter River Salinity Trading Scheme, a cap and trade system, has been implemented to allow participants (eg, mines and electricity generators) to dispose of highly saline water whilst managing the level of salinity in the river.⁴⁹ This has improved the efficiency of salinity management.

Pollution mitigation is a major driver of costs in sewerage management. At present, most environmental regulations license a business or plant to pollute a certain amount in each period. Creating a cap and trade scheme would lead to a more efficient allocation of pollution rights and increase flexibility, allowing environmental objectives to be met at least cost.⁵⁰ It might also facilitate greater competition in the provision of sewerage treatment (particularly inland, where pollution mitigation costs are the greatest).

Road pricing promotes competition between modes of transport

We consider that road pricing would level the playing field between modes of transport. Road pricing represents a substantial opportunity for reform in Australia. While some privately funded roads are tolled, the vast majority of roads continue to be accessed without charge. Road pricing provides a more efficient link between road use, road charges and road costs, and hence more efficient intra-modal choice. There are 2 main areas of potential benefit from introducing road pricing. The first is addressing urban congestion. The second is allowing more efficient use of the existing road network by heavy vehicles.

Urban road congestion is a growing problem for Australia's capital cities. Congestion imposes direct costs on all road users. During periods of peak demand, roads are allocated through queuing which imposes a far greater cost to road users and the economy than would an effective pricing mechanism. The lack of road pricing results in distortions that affect other modes of transport, such as public transport, which is priced. It also means that road users face little incentive to shift demand from peak to off-peak periods and thereby make more efficient use of existing road infrastructure.

An effective pricing mechanism would also improve the allocation of roads to heavy vehicles. Heavy vehicles are currently restricted from accessing large parts of the road network. This is due in part to local councils being unable to recover the additional maintenance costs caused by heavy vehicles. The lack of road pricing also distorts markets for other modes of transport (such as freight rail) that could be used as a substitute for road transport of freight. All parties

⁴⁹ <http://www.epa.nsw.gov.au/licensing/hrsts/>, accessed 6 June 2014.

⁵⁰ Activities that mitigate unregulated pollution, such as stormwater runoff, could be granted credits.

could be made better off if heavy vehicles had a choice of paying to use these roads and if this revenue went directly to those responsible for maintaining the roads.

There have been a number of technological advances, such as sensors and GPS tracking, which could be used on key routes to address road congestion and to charge heavy vehicles for the use of roads.

Does competitive neutrality policy function effectively, and does it apply to the appropriate government business activities?

With respect to competitive neutrality, it is important that CSOs are made explicit and, wherever possible, contestable so that both the public and private sector can access them. On the other hand, it is important that SOCs are not placed at a disadvantage because they are required to pursue unfunded non-commercial objectives. We have identified some aspects of the *State Owned Corporations Act 1989* (NSW) (SOC Act) that inhibit competitive neutrality.

Non-commercial objectives should be transparent and defined

Currently SOCs face a mix of commercial and non-commercial (ie, public policy) principal objectives. In general, the SOC Act and related enabling Acts stipulate that these principal objectives are of equal importance.

This arrangement inhibits competition and undermines the effectiveness of the governance framework in several ways. Treating commercial and non-commercial objectives as equally important:

- ▼ dilutes the focus on SOCs operating efficiently
- ▼ makes it difficult for SOCs to manage their businesses (ie, where conflicts arise between commercial and non-commercial objectives, and it is unclear how to resolve these competing priorities)
- ▼ reduces the accountability of SOCs for their performance, with performance expectations being poorly defined because the relative priority of commercial and non-commercial objectives is unclear.⁵¹

We consider that SOCs should have only commercial objectives. This would allow them to focus on using resources more efficiently and producing goods and services in ways that add the most value, creating an environment more conducive to high productivity and competition.

⁵¹ IPART, *Review of the Productivity Performance of State Owned Corporations - Final Report*, July 2010, p 11 (SOC Report).

As discussed on page 4, we support explicit, budget funded and contestable CSOs. Removing non-commercial objectives from a SOC's principal objectives is consistent with the principle of competitive neutrality. Relative to potential private sector competitors, SOCs should not be advantaged or disadvantaged by virtue of their state ownership (ie, they should not have additional requirements imposed on them, or additional privileges granted to them).

Several markets in which the SOCs operate are open to private operators. All SOCs need a level playing field to compete, and should only be responsible for non-commercial (eg, social, environmental and regional development) objectives to the extent of being good 'corporate citizens', in line with the practices of reputable private sector operators. SOCs should not be required to fulfil non-commercial objectives above and beyond this threshold.

Governments could pursue non-commercial or public interest objectives through a transparent process. This includes:

- ▼ subjecting new or revised standards (or policy requirements) for SOCs and/or market participants to a cost-benefit analysis
- ▼ only issuing SOCs with Ministerial directions, or imposing licence conditions,⁵² if there are no other viable options (eg, contracting with the SOC or private operator to undertake the non-commercial activity)
- ▼ ensuring Ministerial directions and licence conditions are explicit, publicly disclosed and reimburse the SOC.

The existing Ministerial direction processes in NSW could be amended to be consistent with the above principles.⁵³

The OECD considers it is good corporate governance for the costs of a ministerial direction to be clearly identified, disclosed and compensated for by the Budget.⁵⁴ Explicitly agreeing the costs of meeting non-commercial objectives helps to ensure that these costs are subject to transparent scrutiny. This should increase the likelihood that the targeted benefits arising from the non-commercial activities outweigh the costs, and that these benefits are pursued through the least-cost options.⁵⁵

⁵² For example, licence conditions that require the SOC to undertake non-commercial or public interest activities.

⁵³ SOCs are entitled to be reimbursed for complying with Ministerial directions to undertake non-commercial activities, but not for Ministerial directions relating to the public interest or public sector policies (SOC Act, Sections 11, 20N, 20O and 20P).

⁵⁴ OECD, *Guidelines on Corporate Governance of State-owned Enterprises*, 2005, p 20.

⁵⁵ SOC Report, p 14.

SOCs should be subject to best practice governance requirements

In order to improve their governance, the SOC should be subject to best practice requirements. Applying the *Corporations Act 2001* (Cth) (Corporations Act) to them would be an important step towards achieving this aim. It would clarify the range of duties the directors owe to the SOC and introduce independent oversight of the SOC governance arrangements by ASIC. It would more closely align the SOC governance framework with the one for private sector entities, which is consistent with the principle of competitive neutrality.⁵⁶

That said, we consider there will be a limited range of instances where it will be appropriate for the SOC governance framework to depart from the Corporations Act. For example, when SOC directors are required to:

- ▼ undertake non-commercial or public interest activities
- ▼ take steps to rectify potential insolvency situations.

SOCs should remain vehicles for Government to pursue social programs under specific conditions (outlined above). Further, SOC do not face the same market disciplines as their private sector counterparts, such as the ability of shareholders to sell their shares if the SOC is not meeting its financial performance targets.

⁵⁶ For further reading, see Rennie, M and Lindsay, F, *Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and their Relevance for Other Countries*, OECD Corporate Governance Working Papers No. 4, 2011, p 41.

5 Potential reforms in other sectors

Would there be a net public benefit in encouraging greater competition and choice in sectors with substantial government participation (including education, health and disability care and support)?

We consider that there is likely to be a net public benefit in encouraging greater competition and choice in sectors with substantial government participation. Competition and choice in these sectors can be promoted by ensuring that fees for government services reflect efficient costs. We support market-based mechanisms to drive competition and innovation in sectors that are traditionally provided by the government, such as health and education, with consideration of social policies that ensure equitable access to these services through explicit and contestable CSOs.

We consider that competition and innovation in the NSW vocational education and training (VET) market exemplify ways that the private sector can be encouraged to participate in sectors that are traditionally provided by the government.

Fees for government services should reflect efficient costs

Ensuring that fees for government-provided services reflect the efficient costs of providing services is essential to encourage private sector involvement in areas that have traditionally been provided by governments (such as education and health).

We support competition and innovation in the VET market

In 2015, the NSW Government will implement demand-driven provision of VET through *Smart and Skilled*.⁵⁷ Students will be able to choose a training provider that best suits their needs, pay the relevant student fee and then, where government funding applies to that student, Government will pay the relevant subsidy. Training providers will need to comply with the *Smart and Skilled Quality Framework* to deliver government-funded training. We support this reform and consider that it would underpin competition and innovation in the NSW VET market.

⁵⁷ In 2013, the NSW Government asked IPART for advice on an approach to determine prices, fees and subsidies for *Smart and Skilled*. See IPART, *Pricing VET under Smart and Skilled – Final Report*, October 2013.

The NSW Government has indicated that it will initially regulate both the student fee and government subsidy levels for all government-funded VET. We consider that Government should gradually remove student fee regulation to further encourage competition.

We also note that any efficient market requires that customers have sufficient information to make informed choices. Therefore, in addition to the NSW Government's reforms to the quality framework for VET, we consider that information on the performance of each individual training provider should be made publicly available to assist students choose between training providers.

Remove non-competitive restrictions on imported ethanol

Both the NSW and Commonwealth Governments have non-competitive regulations that protect the domestic ethanol industry. They operate by either mandating the sale of ethanol-blended petrol or limiting competition from imported ethanol.

The NSW Government has a policy that mandates that 6% of petrol sold in NSW must be ethanol.⁵⁸ To date, ethanol-blended petrol has primarily been sold as 'E10' (ie, regular unleaded petrol blended with up to 10% ethanol). This means that about 60% of petrol sold in NSW must be E10.

The Commonwealth Government effectively imposes a higher excise on imported ethanol than applies to domestically-produced ethanol, which in practice currently makes importing ethanol uneconomic. While recent changes in the Commonwealth budget are an improvement, there will remain a significant differential excise between domestic and imported ethanol. The differential will fall from the current 38 cents per litre to 26 cents per litre by 2021. We welcome this improvement, but consider that a further reduction would increase competition in the supply of ethanol, delivering benefits to customers.

Further, governments should ensure that state and federal schemes are complementary, having regard to the incentives that they provide and their effect on the market. In the case of ethanol, the Commonwealth Government is limiting competition from imports and the NSW Government is requiring the sale of ethanol. This combination has the potential to be costly for customers.

⁵⁸ <http://www.resourcesandenergy.nsw.gov.au/energy-consumers/sustainable-energy/office-of-biofuels>, accessed 6 July 2012.

Can competition be increased in other markets currently served by government operated providers?

Make CSO funding contestable to encourage competition

We consider that competition can be increased in markets currently served by government operated providers, as discussed previously in this submission. CSOs are non-commercial and designed to achieve government objectives and should be government funded. The government has an obligation to its taxpayers to minimise its cost. We consider that CSOs should be open to contestability. CSO contestability should be outcomes-focused⁵⁹ and designed to allow competitive pressures to drive costs down.

The nature of the competitive processes will need to take into account the nature of the CSO. The competitive process to win a CSO to construct an asset, such as a desalination plant, would likely be different to the process to win a CSO to run ongoing services with greater scope for competition, such as public transport. The aim of making CSOs contestable is to enhance competition in areas where government traditionally was the sole provider of services. Competition drives efficiencies and innovation and care must be taken to ensure that there are functioning competitive tendering processes in place.

CSOs should be available to multiple suppliers. It is important that programs that are designed to achieve welfare objectives for customers should be available to all suppliers. For example, in NSW the state government funds CSOs to state owned water utilities to subsidise the bills of pensioners. We consider that these CSOs should also be available to privately owned water utilities to ensure competitive neutrality while maintaining the government's welfare objectives.⁶⁰

⁵⁹ For example, in 2007 the NSW Government directed Sydney Water to build the St Mary's Replacement Flows project, to increase environmental flows into the Nepean River. An outcomes-based CSO tender to provide a certain quantity of environmental flows upstream of a certain point would have been more conducive to innovative solutions to achieve the government's policy objective.

⁶⁰ Under Section 13(3)(b) of WICA, the Parliament of NSW has the power to fund social programs for private water utilities.

6 Competition laws

Should the recommendations in the Productivity Commission’s report on the National Access Regime be adopted? Are there other changes that could be made to improve competition in the relevant markets?

The PC’s recommendations on the National Access Regime should be adopted

Overall, we consider that the National Access Regime works relatively well and we support the recommendation of the Productivity Commission’s report on the National Access Regime. We suggest some improvements based on our experience as the economic regulator in NSW.

Two access regimes are relevant to IPART. The *Water Industry Competition Act 2006* (NSW) (WICA) provides for a water access regime that has been certified under Part IIIA of the *Competition and Consumer Act 2010* (CCA): CCA, Section 44N and the NSW Rail Access Undertaking (Undertaking) that was made under the *Transport Administration Act 1998* (NSW). This Undertaking has not been certified.

The most relevant recommendations to IPART are:

- ▼ Recommendations 8.1 to 8.4 which confine declaration to where it is most likely to promote material increase in competition, to better target the economic problem and to better account for the costs of providing the infrastructure service.
- ▼ Recommendation 8.6 which strengthens the regime’s framework role and reduces administrative costs.
- ▼ Recommendation 8.8 which is aimed at ensuring that future mandatory undertakings are used to target the economic problem.

While the National Access Regime generally has worked well, improvements can be made in the way the NSW Rail Access Undertaking is administered. For example, we regulate around 21km of the Hunter Valley Coal network which is operated by RailCorp. The rest of the Hunter Valley Coal network is operated by ARTC and is regulated by the ACCC. Rail freight companies have to negotiate access with both operators, under 2 different regulatory regimes. This issue is discussed in more detail in the next chapter.

7 Administration of competition policy

Are competition-related institutions functioning effectively and promoting efficient outcomes for consumers and the maximum scope for industry participation?

Regulators can improve their processes and performance

We have observed a number of opportunities to enhance the function of competition-related institutions.

There are a large number of competition-related institutions in Australia, including jurisdictional economic regulators, the ACCC, the AER, the AEMC and the Australian Competition Tribunal. We consider that while these bodies have helped deliver many of the benefits of competition to date, there is scope for improving the functioning of these institutions to deliver better outcomes for customers.

We oppose splitting regulatory responsibility between organisations. There are currently 2 examples where regulation has in part moved from IPART to the ACCC. As a result, a single business has ended up with 2 economic regulators. In both cases, IPART has been left regulating a relatively small part of the market.

- ▼ IPART regulates 3 valleys for State Water. The Murray-Darling basin is regulated by the ACCC.
- ▼ As noted in Chapter 6, IPART regulates around 21km of the Hunter Valley Coal rail network. The ACCC regulates the remaining 650km of track.

This split of regulatory responsibility is more costly for access seekers and the regulated business. Rail freight companies have to negotiate access with both network operators, under 2 different regulatory regimes adding unnecessary costs. Another practical outcome is that the regulator regulating the relatively small assets can find it difficult to get stakeholders to engage in the review.

Further, we consider that where merits review is available, it needs to be well-designed to ensure that it results in a better overall decision. The decision should be materially preferable to the first-instance decision. Limiting the review panel to making a materially preferable decision requires the review body to balance its decisions and limits the opportunity for stakeholders to ‘cherry-pick’ elements of the first-instance decision for appeal. That is, we consider that the appeal body should be required to ‘stand in the shoes of the regulator’. The appeal panel should be limited to reviewing the information that was before the first-instance decision maker, in order to limit opportunities to game the process.

In any case, a good consultation process leads to better decision-making, which should lessen the likelihood of appeal. In general, these organisations undertake rigorous processes, but we should continually seek to improve our consultation practices.

What institutional arrangements would best support a self-sustaining process for continual competition policy reform and review?

Regulators should report on competition

The Issues Paper asks stakeholders to identify priorities for a competition policy reform agenda.⁶¹ We recommend that the relevant independent economic regulator in each state and territory provide a report periodically (say, every second year for a period of 10 years) against the priority areas identified in this review.

As well as reporting against these priorities, the regulator could also make further recommendations for reform in key areas. Periodic reporting on the state of competition and reform in each jurisdiction would identify opportunities for competition reform and advance the reform agenda on an ongoing basis.

Was the Council of Australian Governments competition agenda, with reform payments overseen by the National Competition Council, effective?

Competition payments can incentivise reform

We consider that competition reform payments were effective in encouraging economic reforms in the past. Competition payments under the National Competition Policy helped motivate states and territories to undertake economic reforms from 1997 to 2006. The jurisdictions were annually held to account by the National Competition Council to report progress on the agreed reform program, particularly for the review of legislation.

⁶¹ Competition Policy Review Issues Paper, April 2014, p 7.

We consider that competition payments could be used to fund compensation of incumbents in industries suffering losses arising from competition reforms. We recognise that some reforms in the current regulatory framework could lead to the erosion of existing rights of incumbents operating in certain industries. Competition payments could be a means of providing compensation to those who experience material losses arising from regulatory reform that increases competition. We consider that states and territories would be well-placed to allocate competition payments to incumbents from losses arising from reforms.