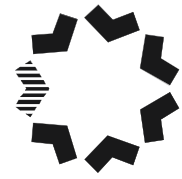


NATIONAL
COMPETITION
COUNCIL



Competition Policy Review

National Competition Council
submission on the issues paper



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1 Introduction

- 1.1 The National Competition Council (Council) is a statutory agency established by Part IIA of the *Competition and Consumer Act 2010* (CCA). The Council is responsible for providing recommendations to designated Commonwealth and state or territory ministers in relation to third party access to infrastructure services under Part IIIA of the CCA and for recommendations and decisions relating to access to natural gas pipelines under the *National Gas Law* (NGL).
- 1.2 Until 2005, the Council also had a range of functions in relation to the National Competition Policy (NCP) and related reform program. In particular between 1997 and 2005 the Council prepared public assessments of the performance of state and territory governments and of the Commonwealth Government in meeting the commitments they had agreed to under the NCP. Based on these assessments the Council advised the Commonwealth Treasurer in relation to competition payments payable to the states and territories.
- 1.3 Since the end of the NCP assessment program and competition payments, the Council's role has been confined to consideration of applications relating to third party access under Part IIIA and the NGL. Such applications are relatively few and intermittent. This has led to a highly variable workload for the Council and a recent decision by the Council to disband its staff secretariat and purchase secretariat services from the Australian Competition and Consumer Commission (ACCC). This arrangement comes into effect on 1 July 2014.¹
- 1.4 The Council has based this submission on its almost 10 years of experience in administering the NCP and its ongoing experience in dealing with third party access issues under the CCA and NGL.
- 1.5 The submission addresses two particular aspects raised in the Terms of Reference and the Review Panel's Issues Paper under two headings:
 - principles and processes for effective competition policy reform, and
 - the operation of the National Access Regime.
- 1.6 In addition, the Council has provided references and links including to selected documents it produced as part of its NCP role and which the Council considers provide useful background for the Review Panel's current task.
- 1.7 The Competition Policy Review website already provides a link to the Council's National Competition Policy website (www.ncc.ncc.gov.au). As the Review Panel will have observed, this site contains a comprehensive record of information on the development, content and implementation of the NCP.

¹ For additional information on the changes to the Council's secretariat services arrangements see: <http://ncc.gov.au/images/uploads/NCCSecretariatServices-001.pdf>

2 Principles and processes for effective competition policy reform

- 2.1 Australia's NCP and related reform program was established in 1995 and operated for some 10 years. Governments' rationale in establishing the NCP was that the Australian economy needed fundamental reform—to expose all business activity to greater competition—to improve efficiency and productivity, and enhance incomes and wealth for all Australians.
- 2.2 The NCP was a broad ranging and comprehensive reform program (see Box 1). It comprised different types of reforms: specific 'big-ticket' reforms such as the creation of competitive national energy and water markets, the introduction of specific measures to address potential distortions such as competitive neutrality arrangements to ensure that significant publicly owned businesses that compete with private businesses do so on an equivalent footing, and ongoing 'process' reforms that could be fleshed out and implemented over an extended timeframe such as the legislation review and reform program aimed at removing unwarranted legislative restrictions on competition.
- 2.3 The principle underpinning the NCP was the primacy given to the operation of competitive markets wherever appropriate, reflecting the view that vigorous competition delivers a more dynamic economy and, consequently, improved living standards. Under the NCP the onus lay on ensuring that competition prevailed, unless it could be demonstrated that intervention was genuinely necessary to achieve public interest goals. Under the legislation review and reform program, for example, the 'guiding principle' was that (existing and future) legislation should not restrict competition unless it could be demonstrated that the benefits of the restriction to the community as a whole outweighed the costs, and the objectives of the legislation could be achieved only by restricting competition. Any restrictions not shown to provide an overall community benefit were to be removed.
- 2.4 The success of the NCP is well recognised. In particular, the Productivity Commission's 2005 review of the NCP found that the program had 'delivered substantial benefits to the Australian community which, overall, have greatly outweighed the costs' and that the benefits flowed to both country and city Australia (see Box 2). This evidence of success provides cogent support for governments to recommit to a comprehensive microeconomic reform program for Australia. A new program, reinforcing support for competition (unless intervention is in the public interest) and with transparent monitoring and evaluation and incentives to facilitate reform implementation, would help to safeguard Australia's future economic well-being. By continuing such broad scope reform Australia will preserve the gains from the former NCP and make further gains.
- 2.5 After the NCP lapsed, governments through COAG identified new sectoral reform targets. While such activity is undoubtedly important, the continuing success of the Australian economy depends on governments and the community committing to

broad-based pro-competitive economic reform and meeting that commitment. Australia will benefit by retaining and promoting what the Organisation for Economic Cooperation and Development called at the time of the NCP a 'deep-seated competition culture' (OECD 2005).

Box 1 The National Competition Policy and related program

For over 10 years, the NCP provided a basis for cooperative federalism in relation to microeconomic reform. The NCP was founded on a set of intergovernmental agreements that all Australian governments entered in 1995. Reforms under the agreements encompassed:

- an extension of competition law to all business activity in Australia, ensuring measures to prevent anticompetitive conduct apply to professions, unincorporated businesses and the business activities of governments
- reform of public monopolies, including the separation of regulatory and commercial activities and an examination of the desirability of separating monopoly activities from potentially competitive ones
- competitive neutrality, so government businesses compete with the private sector on a fair basis
- the creation of independent regulators to oversee or set prices for services supplied by monopoly suppliers
- legislation review and appropriate reform to remove unjustified restrictions on competition
- the introduction of 'gatekeeping' arrangements, to maintain the quality of regulation
- a national access regime, to provide effective third party access to the services of essential infrastructure
- specific reforms in the energy, water and road transport sectors.

Outcomes under the NCP

- 2.6 The Council's final assessment of governments' reform implementation performance, completed in 2005, found that the NCP had been a considerable success, leading to greater prosperity for Australia. While the 2005 assessment acknowledged that more needed to be done in some areas, the Council's overall conclusion was that many reform objectives under the NCP had substantially been met (NCC 2005, p xvii).
- 2.7 In similar vein, the Productivity Commission's Review of National Competition Policy Reforms, which reported in 2005, found that the NCP had delivered substantial benefits to growth and productivity (see Box 2). The Productivity Commission found that the NCP was an important contributor to Australia's (then 13) years of continuous economic growth, leading to benefits to all Australians—across all income levels and in cities and regions. The Productivity Commission recognised nonetheless (as had the Council in its 2005 assessment) that more needed to be done. In particular, the Productivity Commission argued that 'further reform on a broad front is needed to secure a more productive and sustainable Australia' (PC 2005, p. ii)

Box 2: The Productivity Commission's review of NCP reforms (2005)—key findings

The National Competition Policy has delivered substantial benefits to the Australian community which, overall, have greatly outweighed the costs. It has:

- contributed to the productivity surge that has underpinned 13 years of continuous economic growth, and associated strong growth in household incomes
- directly reduced the prices of goods and services such as electricity and milk
- stimulated business innovation, customer responsiveness and choice and
- helped meet some environmental goals, including the more efficient use of water.

Benefits from NCP have flowed to both low and high income earners, and to country as well as city Australia—though some households have been adversely affected by higher prices for particular services and some smaller regional communities have experienced employment reductions.

Though Australia's economic performance has improved, there is both the scope and the need to do better. Population ageing and other challenges will constrain our capacity to improve living standards in the future. Further reform on a broad front is needed to secure a more productive and sustainable Australia.

In a number of key reform areas, national coordination will be critical to good outcomes. These areas—many of which have been encompassed by NCP—should be brought together in a new reform program with common governance and monitoring arrangements. Priorities for the program include:

- strengthening the operation of the national electricity market
- building on the National Water Initiative to enhance water allocation and trading regimes and to better address negative environmental impacts
- developing coordinated strategies to deliver an efficient and integrated freight transport system
- addressing uncertainty and policy fragmentation in relation to greenhouse gas abatement policies
- improving the effectiveness and efficiency of consumer protection policies and
- introducing a more targeted legislation review mechanism, while strengthening arrangements to screen any new legislative restrictions on competition.

An 'overarching' policy review of the entire health system should be the first step in developing a nationally coordinated reform program to address problems that are inflating costs, reducing service quality and limiting access to services.

National action is also needed to re-energise reform in the vocational education and training area.

Reform is important in other key policy areas, including industrial relations and taxation, but there would be little pay-off from new nationally coordinated initiatives.

The Australian Government should seek agreement with the states and territories on the role and design of financial incentives under new national reform programs.

Source: PC 2005, Review of National Competition Policy Reforms, p xii.

Why did the NCP succeed?

2.8 The success of the NCP lay in a combination of three elements. First, governments agreed to an appropriate reform **agenda**. Second, they established an **assessment and accountability process** to ensure that their progress against the agreed agenda was assessed and reported in a rigorous, transparent and independent manner. Third, there were fiscal **incentives** (known as competition payments) made available by the Commonwealth Government to state and territory governments to encourage reform progress. The availability of these payments (and the threat of the loss of the

payments) provided a means of both distributing the gains from reform and stiffening governments' resolve to implement change.

- 2.9 Australia's federal system of government means that the policies and actions of all nine Australian governments have a significant impact on the performance of the Australian economy and on the productivity and prosperity of its people. Some policies and actions are the responsibility of a particular level of government; other matters require cooperative federalism—coordination and cooperation among several or all governments. The NCP, founded on a series of inter-governmental agreements, provided a basis for cooperative federalism in relation to microeconomic reform.
- 2.10 The success of the NCP suggests there is much to be gained by governments recommitting via a cooperative federalist approach to a new broad based economic reform package. There are however two areas where the NCP 'model' could be developed to enhance its effectiveness. First, as the Commonwealth did not receive competition payments, the model provided little incentive for the Commonwealth Government to deliver on its reform commitments (other than the exposure of the Commonwealth's delays in reform implementation via the Council's public assessments). Additional means for encouraging the Commonwealth Government to expeditiously implement any new reform commitments would assist. Second, progress on multi-jurisdictional or national issues (particularly competitive restrictions in legislation) tended to become 'bogged down' in inter-jurisdictional processes and/or debate about appropriate outcomes. Consideration as to how national review and/or reform processes might be most effectively facilitated in a new reform program would be beneficial.

The agenda

- 2.11 For successful implementation a reform agenda needs to be flexible in scope and form—that is, provide for different jurisdictions to undertake reform activities according to their different priorities or schedules. The program should include identifiable 'big ticket' longer term items set out as broad objectives but also smaller specific reforms that can be progressed while the big ticket items are refined and fleshed out. The longer term reform objectives should be capable of conversion over time into smaller more defined goals against which implementation can be assessed.
- 2.12 Also important is an overarching commitment to competition, with a focus on achieving clear public or national interest goals while minimising any restrictions on competition. Rigorous testing of new policies proposing additional or changed regulation to ensure that intervention is justified is a key element.
- 2.13 Under the NCP, reforms included longer term processes aimed at removing unnecessary regulatory or administrative burdens on productivity and the specific 'related reforms'—the development of national electricity and gas markets and national water reform. The longer term 'process' elements had the additional benefit of focusing attention on matters that might otherwise have escaped scrutiny. For

example, the 'process' of ensuring regulatory restrictions on competition were reviewed and removed unless they were shown to be in the public interest involved a commitment to deal with a large number of small items that together represented a substantial drag on the Australian economy. Such small items individually often escape attention but are more likely to be addressed through a broad-based program of review (as they were under the NCP).

- 2.14 Clearly, the reform agenda is a matter for governments to set—ultimately they must 'own' the agenda if they are to implement it. What is important is that governments can be held to their commitments. Accordingly, the agenda must be developed with an eye to the degree to which achievements are able to be objectively assessed.

Assessment and accountability

- 2.15 A worthwhile reform agenda needs to be supported by a process of assessment involving public reporting of progress. Regular transparent assessment reinforces accountability for meeting reform objectives in a timely fashion, by discouraging the dilution of challenging objectives or the 'adjustment' of (unmet) timetables and deadlines.
- 2.16 The existence of independent and informed monitoring of outcomes and transparent reporting on progress (particularly in areas where commitments are not being met) itself provides an incentive for government to meet reform targets.² Transparent accountability processes, by exposing the costs and (often lower) benefits of interventions, assist governments to resist the overtures of sectional interests who seek to restrict or raise barriers to competition without demonstrating that doing so is necessary to meet a genuine public interest, and that the restriction they propose will achieve this goal.
- 2.17 Under the NCP the Council conducted regular assessments of the performance of all Australian governments in meeting the reform goals they had agreed: in 1997, 1999 and 2001, and then annually until 2005.³ The assessment reports were public documents and the assessment findings carried consequences in the form of reduced competition payments from the Commonwealth to the states and territories as their share of the economic gains generated by the agreed reforms.
- 2.18 The Council's advocacy of independent monitoring and assessment should not be seen as it seeking reinvigoration of its former NCP role. The Council has not retained particular expertise in that area since 2005. What is important is that there is regular transparent evaluation of reform implementation. Such evaluation needs to be independent: the parties directly involved in establishing and implementing reform agendas cannot credibly undertake such a role.

² Direct incentives also provide important encouragement. Direct incentives are discussed below.

³ The Council also conducted some 'supplementary' assessments, where progress on particular issues had not met targets.

2.19 Other processes that assist accountability, such as regulatory gatekeeping to ensure that any intervention is necessary, are also important and need to be further strengthened. Processes for testing regulatory proposals (both the mundane and the popular)—need to ensure regulation is justified in the public interest, is effective and minimises restrictions on competition.

Incentives to encourage desirable outcomes

2.20 Successful microeconomic reform is not necessarily easily achieved. It requires will among governments which can be translated into a meaningful agenda, backed up by assessment and, in the view of the Council, complemented by incentives for achievement.

2.21 Elements of a reform agenda can pose political problems for at least some governments and some may produce fiscal disadvantage for a particular government. Under the NCP, the availability of financial incentives assisted greatly in achieving necessary reforms. They provided both a means of distributing the gains from reform and a way for governments to meet legitimate demands for adjustment assistance. The particular form of the financial reward is possibly less important, although the Council's experience suggests that the NCP approach, whereby there was a pool of funds available in relation to the entire reform program, is likely more effective than linking particular reforms to specific reward outcomes.

2.22 It might legitimately be asked whether there is a case for state and territory governments to receive funding from the Commonwealth to persuade them to take action that will produce significant benefits. In the Council's view, the experience of the NCP showed that financial incentives and penalties for failure assisted in achieving reform outcomes, outcomes which were likely to have provided greater benefit than the relevant level of payment. The available incentives and prospect of penalties—even where these were pitched at a relatively low level in relation to a particular matter—provided state and territory governments with justification for undertaking reforms that were difficult, and in several cases stiffened governments' resolve to undertake reform. Fiscal penalties, in particular, focused attention on failed or excessively delayed reforms.

2.23 The Council's experience with the NCP suggests that there is a legitimate role for financial incentives to assist implementation of any future reform agenda.

3 Operation of the National Access Regime

- 3.1 In October 2013 the Productivity Commission completed its inquiry into the National Access Regime. That inquiry was undertaken over a 12 month period and involved publication of a draft report, consideration of over 70 submissions and roundtable discussions of legal and economic issues as part of wide ranging consultation. The Council's submissions to the inquiry are listed in the references section of this submission.
- 3.2 In large part the Council supports the Productivity Commission's conclusions and recommendations and considers that these will enhance the objectives of the National Access Regime as envisaged by the Hilmer Committee. These objectives in turn support the principles underpinning the NCP which the Council considers to be still relevant today.
- 3.3 The Council supports the Productivity Commission's conclusion that the National Access Regime should be retained (PC 2013, p 2). The Regime provides a net benefit to the community by promoting competition and investment in dependent markets where access to monopoly infrastructure services is required to compete effectively in those dependent markets.
- 3.4 The Regime operates as a disincentive for service providers to refuse access and an incentive for parties to agree on terms of access through commercial negotiation so encouraging parties to arrive at access terms and conditions without direct regulatory intervention. It therefore provides an important 'backstop': without an access regime and where successful claims and effective remedies under s 46 of the CCA are elusive, remedying third party access issues would fall back on ad hoc regulatory responses such as deemed declarations, industry-specific regimes and mandatory undertakings.
- 3.5 Access regulation, like any other economic regulation, is intrusive. It will affect, for example, the general freedom of a supplier of infrastructure services to choose when and with whom it conducts business and on what terms and conditions. While asset owners may object to being constrained in this way, such objections do not justify removal of access regulation. As the Hilmer Committee recognised, 'there are some industries where there is a strong public interest in ensuring that effective competition can take place, without the need to establish any anti-competitive intent on the part of the owner for the purposes of the general conduct rules' (Hilmer Committee 1993, p 248).
- 3.6 An effective National Access Regime is an important part of a comprehensive competition policy for Australia. It supports competitive neutrality and provides a default mechanism for addressing access issues that arise in the operation of state-owned infrastructure and when (and if) such assets are privatised. To the extent that the privatisation of public assets is considered in any new reform agenda, excessive market power that may impede the introduction of competition into the market(s) served by the public monopoly market needs to be addressed. This should encompass in the first instance consideration of structural separation and removal of

any remaining responsibility for industry regulation from the public enterprise. The merits of separating the natural monopoly and potentially competitive elements of the public enterprise should also be examined.

- 3.7 The Council strongly supports many of the Productivity Commission's more specific recommendations in relation to the National Access Regime. In particular the Council agrees that the Government should legislate to amend declaration criteria (a) and (b). In the case of criterion (a) the action recommended will confirm in law the current approach to applying the criterion. In the case of criterion (b) the recommended change will mean that the criterion tests for the presence of natural monopoly characteristics⁴ in the supply of the service for which declaration is sought (rather than test whether it would be 'profitable' for anyone to provide an alternative facility, which is the construction of criterion (b) determined by the High Court in its Pilbara rail judgment).
- 3.8 The Council also supports the Productivity Commission's recommendation that criterion (e) should be removed as a criterion for declaration and a threshold clause stating that a service cannot be declared if subject to a certified state or territory access regime and a mechanism for revoking the certification of a regime should be introduced. This will simplify the interface between state and territory access regimes and the national regime and increase certainty as to which regime applies in any case.
- 3.9 The one significant recommendation that the Council does not support is the proposal to change the interpretation of criterion (f): whereby the criterion would become a test of whether declaration is in the public interest (rather than, as at present, a test that declaration is not contrary to the public interest). The Council suggests that the Review Panel should advise the Government not to adopt this particular recommendation.
- 3.10 The Productivity Commission considers this change to be necessary because:
- ...the current construction of the public interest test sets a hurdle for declaring an infrastructure service that is too low to ensure that access regulation is only applied where it is likely to generate net benefits to the community (PC 2013, pp 178-9)
- 3.11 It is unclear on what basis the Productivity Commission reaches this view given it also finds that the Hilmer Committee's intention that the Regime be applied sparingly has been borne out in practice and that only six declarations have occurred in the nearly 20 years since the Regime was introduced.
- 3.12 Amending criterion (f) as proposed by the Productivity Commission will also set aside a series of precedents which have helped define the meaning of this criterion and significantly increase the prospect of litigation in relation to the interpretation of the

⁴ An infrastructure facility demonstrates natural monopoly characteristics where the total reasonably foreseeable market demand for the service of the facility is likely to be met at lower total cost by the (single) facility rather than by two or more facilities.

criterion. In the absence of compelling reasons for change such risks and the resulting costs and uncertainty should be avoided.

- 3.13 In the Council's view the declaration criteria taken together—as they must be—already represent a sufficiently high hurdle for declaration of a service and the amendment to criterion (f) proposed by the Productivity Commission is unnecessary and undesirable. There is a genuine risk that raising the hurdle higher will render declaration impossible and as a result nullify any effective threat from declaration as a means of encouraging private settlement of access disputes.
- 3.14 As it currently applies, criterion (f) allows for declaration to be refused where access would be contrary to the public interest even where all of the other declaration criteria are met. This already allows declaration to be refused where it would have an adverse net effect on the community.
- 3.15 Under the Productivity Commission's recommended approach a further positive public interest case for declaration would be required in order to satisfy criterion (f) notwithstanding that to have satisfied the other declaration criteria it is already necessary to establish: national significance; that declaration would overcome natural monopoly barriers to competition; and that declaration would materially increase competition in a market.
- 3.16 In the Council's view where an application for declaration has satisfied all of the other declaration criteria it should not have to meet a further public interest requirement. There is a very real risk that as a result of further raising the threshold for declaration to an unachievable height, the incentives for parties seeking access to bypass declaration in favour of seeking industry specific access regulation will be greatly strengthened.
- 3.17 Already most regulated third party access occurs as the result of state or territory access regimes or mandatory requirements for access undertakings. Further raising the threshold for declaration will reinforce this trend and encourage parties wanting access to seek it through lobbying rather than an application for declaration. If the Review Panel and the Government are comfortable with such a situation continuing then it may be unnecessary to provide for a statutory declaration mechanism. In such circumstances, rather than relying on the Council advising on whether the statutory declaration criteria are satisfied, it might well be more realistic to accept that regulation of third party access will result from ad hoc policy and legislative action and rely on policy-making processes (including some assessment of regulatory impacts) to limit the scope of such action.

4 References

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