



# Briefing Paper to the Business Council Of Australia Sustainable Growth Task Force

2005

## Development and Implementation of National Competition Policy

### Overview

This briefing paper is intended to provide a background to Australia's national competition policy. The briefing paper sets out a brief history of national competition policy and outlines its framework; reviews the progress in its implementation and the role it has played in Australia's recent economic performance and suggests that the key contributing factors to the success of the implementation of national competition policy could be adopted by the task force in implementing sustainable growth initiatives.

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# Executive Summary

Between 1960 and 1992, Australia went from being the third richest OECD nation to the fifteenth. The protection from internal and external competition of large sectors of the economy contributed to much of this decline. Protected businesses had little incentive to reduce costs and prices, to produce new, innovative products or to use resources as efficiently as possible.

In 1992, the Council of Australian Governments commissioned Professor Fred Hilmer to Chair an independent Committee of Inquiry into National Competition Policy. In 1995, acting on the Hilmer Report's recommendations, a number of reforms were drawn together to form a package, agreed upon by all Australian Governments called National Competition Policy. The National Competition Policy reforms were designed to enable and encourage competition to improve the wellbeing of Australians.

Australia's nine governments signed three agreements establishing the National Competition Policy on 11 April 1995. These agreements are: the Competition Principles Agreement; the Conduct Code Agreement; and the Agreement to Implement the National Competition Policy and Related Reforms. The introduction of National Competition Policy also saw the creation of the independent National Competition Council.

Under the National Competition Policy, the Australian Government makes payments to the States and Territories as a means of sharing the gains from regulatory and other micro-economic reforms and to provide financial incentives for the States and Territories to implement their agreed NCP commitments. In assessing governments' progress in implementing NCP, the NCC advises the Treasurer periodically on each government's progress and the allocation of the competition payments. In relation to the 04/05 year, for example, on 21 December 2004, the Treasurer announced that the Commonwealth will make competition payments to the States and Territories totalling more than \$724.1 million, but in doing so, several State governments received significantly less than the total payment available in light of poor progress on issues such as retail gas contestability, shop trading hours, and primary industry regulation.

Although implementation of the package of reform remains incomplete, much has been accomplished since the NCP was introduced in April 1995. A wide range of activities – including infrastructure services, agricultural marketing, professions, occupations, financial services, retail trade and water resource management, have undergone substantial change. Quantitative modelling by the Productivity Commission indicates that recent productivity improvements and price changes in six key infrastructure sectors have generated a permanent increase of 2.5 per cent in Australia's GDP. Such modelling does not pick up the dynamic efficiency gains from competitive markets.

The success of the National Competition Policy model has been attributed to three key interrelated aspects of Australia's institutional framework:

- a an agenda agreed by all governments that outlines the reform commitments with a practical degree of specificity;
- b a fearless and independent body responsible for negotiating, monitoring and reporting on reforms; and
- c the provision of appropriate incentives including financial payments.

The task force has much to learn from the implementation of National Competition Policy.

# Background to the National Competition Policy

## Australia's economic performance prior to the establishment of the Hilmer Committee

Australia's economic performance during the 1970s and 1980s deteriorated markedly. Output growth slowed, inflation and unemployment rose and living standards (in terms of per capita incomes) relative to those in many other developed countries declined. While external developments contributed to this deterioration, recognition began to grow that domestic policy and institutional factors were constraining Australia's productivity potential and were responsible for much of its economic malaise.

Landmark policy decisions in the early 1980s to float the currency and remove controls on foreign capital flows signalled the first steps in reversing Australia's declining economic fortunes and establishing a more flexible and outward looking economy. Trade reforms followed, initially with the abolition of import quotas and later, phased reductions in tariff assistance. In the second half of the 1980s, a number of reports highlighted significant inefficiencies in infrastructure service provision. Such inefficiencies not only imposed cost on domestic users, but also reduced the international competitiveness of the traded goods sector. In response, governments at all levels began to focus on improving the performance of key infrastructure sectors such as energy, transport and communication services.

The reform program gathered pace into the 1990s. It became apparent that the limited scope of existing competition policy arrangements, encompassed primarily within Part IV of the *Trade Practices Act 1974 (Cth)* (**the TPA**), was insufficient to drive further reform and the development of a more internationally competitive economy. (This view was reflected in the 1991 Prime Ministerial statement – *Building a Competitive Australia*: the *Trade Practices Act* is our principal legislative weapon to ensure consumers get the best deal from competition. But there are many areas of the Australian economy today that are immune from the Act: some Commonwealth enterprises, State public sector businesses, and significant areas of the private sector, including the professions.

This patchwork coverage reflects historical and constitutional factors, not economic efficiencies; it is another important instance of the way we operate as six economies, rather than one. The benefits for the consumer of expanding the scope of the *Trade Practices Act* could be immense: potentially lower professional fees,

cheaper road and rail fares, cheaper electricity. (Hawke 1991 p.1761).)

Governments saw merit in adopting a coordinated and systematic approach to competition policy reform.

## The Hilmer Committee

Following agreement by all Australian governments on the need for a national policy, in October 1992, the then Prime Minister established an independent *Committee of Inquiry into a National Competition Policy for Australia*, known as the Hilmer Inquiry after its chairperson, Professor Fred Hilmer.

The Committee saw its task as proposing the most effective form, content and implementation approach for a national competition policy that would support an open, integrated domestic market for goods and services. The Committee considered competition policy in terms of the following specific elements: limiting anti-competitive conduct of firms (for example, competitive conduct rules of Part IV of the TPA); reforming regulation which unjustifiably restricts competition (for example, deregulation of domestic aviation, egg marketing and telecommunications); reforming the structure of public monopolies to facilitate competition (for example, proposed restructuring of energy utilities in several States); providing third party access to certain facilities that are essential for competition (for example, access arrangements for the telecommunications network); restraining monopoly pricing behaviour (for example, prices surveillance by Price Surveillance Authority) and fostering competitive neutrality between government and private businesses when they compete (for example, requirements for government businesses to make tax-equivalent payments).

In accordance with its terms of reference, the Committee took account of a wide spectrum of

community views including overseas approaches where they were thought to offer lessons for Australia. The Committee reported in 1993 and made very extensive recommendations in six policy areas:

- the operation of the competition provisions of the TPA should be extended to apply to unincorporated businesses and State and Territory government businesses, which had until that time been exempt;
- federal price surveillance legislation should be extended to public sector businesses;
- competitive neutrality principles should be applied in the operation of public sector businesses such that they should not enjoy a competitive advantage simply as a result of public sector ownership;
- the introduction of a mechanism to facilitate the pro-competitive structural reform of public monopolies;
- all legislation of the various State, Territory and Federal governments which restricted competition (for example, statutory marketing schemes for products such as milk and wheat, restrictions on the ownership of certain types of businesses and so on) should be reviewed and repealed unless that legislation could be justified on the grounds of net public benefit and there was no practical way to achieve that public benefit by more competitively benign means; and
- a statutory form of essential facilities doctrine should be adopted to providing for third party access to nationally significant infrastructure.

### The appropriate institutional structure

The Hilmer Committee's views on the appropriate institutional structure for implementing a national competition policy were shaped by the detail of its policy proposals, and by its judgment on two key issues.

First, the Committee began with a sceptical bias against the need to establish separate regulators for individual industries. Apart from the risk of 'capture' by the regulated industry in each case, approaches of this kind would fragment the application of the proposed policy and raise issues of consistency between industries. There would also arise forgone opportunities to develop and apply the insights gained in one industry to analogous issues in other industries, a fragmentation of regulatory and analytical skills and typically greater administrative costs. Overall, the Hilmer Committee was satisfied that

all aspects of its proposed policy framework could be fully and effectively performed by one economy-wide regulatory body with access to appropriate expertise through the use of consultants or through development of internal expertise.

The second and more difficult issue concerned the respective roles of the Commonwealth, State and Territory governments. While the Committee supported the adoption of cooperative models, this view was tempered by the need to provide streamlined decision-making processes where important national interests were at stake and the importance of ensuring competition regulators could operate independently. The Committee was also influenced by the extent to which particular elements of its proposed policies impinged upon the prerogatives of individual governments.

The outcome from these considerations was that the Hilmer Committee recommended that a National Competition Council be established jointly by the Commonwealth, State and Territory Governments to play a key role in policy decisions, relating to the additional policy elements. While the composition of the body would be settled by all governments, the objective was to provide one high level and independent analytical and advisory body in which all governments would have confidence.

The Hilmer Committee also recommended the establishment of an Australian Competition Commission, merging the existing Trade Practices Commission and Prices Surveillance Authority, and the renaming of the Trade Practices Tribunal to the Australian Competition Tribunal.

The Commonwealth could have implemented most of the Hilmer Committee's recommendations through the use of its existing heads of constitutional power, however, the Committee favoured a cooperative approach to extending the coverage of the general conduct rules in the interests of comity, simplicity of legal drafting and certainty. A referral of powers from the States was considered by the Committee to be the preferred model.

# National Competition Policy

## The benefits of National Competition Policy

To help it assess the benefits of adopting the Hilmer Committee's recommendations, the Council of Australian Governments (CoAG) asked the Industry Commission to quantify the potential economy-wide impacts of key competition policy reforms. In its report to CoAG, the Industry Commission estimated that once the reforms had fully worked their way through the economy, Australia's real GDP would be 5.5 per cent, or \$23 billion a year, greater than otherwise; households would, on average, benefit by around \$1500 per year; aggregate employment could rise by 30,000; and there would be large revenue gains for the Australian, State and Territory Governments. In light of the prospective gains, and in recognition of the benefits from a nationally coordinated approach, each jurisdiction committed, in April 1995 to a far reaching six year program of competition reform (subsequently extended to 2005) broadly in line with the Hilmer Committee recommendations. This program also incorporated previously agreed CoAG reforms in electricity, gas, water and road transport.

## NCP Agreements

Following the recommendations of the Hilmer Committee, in April 1995, the State, Territory and Federal governments reached agreement on the adoption of a working competition policy. The resulting National Competition Policy (NCP) is underpinned by three intergovernmental agreements: the Competition Principles Agreement, the Conduct Code Agreement, and the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement). The three agreements outlined the reforms which governments undertook to put in place under the NCP process. Related reforms in the electricity, gas, water and road transport industries also formed part of the package. The agreements are contained within the Compendium of Competition Policy agreements. The agreements were fine-tuned in November 2000 by the CoAG.

Under the agreements, the Commonwealth undertook to make ongoing national competition payments to each State and Territory. We discuss NCP payments below.

Set out below is a summary of the substance of the NCP agreements.

### A. The Competition Principles Agreement

- Sets out the obligations of all of the governments in the areas of prices oversight of State and Territory government business enterprises, competitive neutrality, structural reform of public monopolies and legislation review and reform.
- Applies the reforms to local governments.
- Sets out a (non-exhaustive) list of 'public interest' factors that governments should consider when assessing the costs and benefits of a particular policy or course of action.

- Establishes arrangements for access by third parties to services provided by significant infrastructure facilities.

### B. The Conduct Code Agreement

- Commits State and Territory governments to extending the prohibitions against anti-competitive behaviour in the TPA to virtually all businesses in Australia (by the adoption of parts of the TPA in State and Territory legislation).
- Requires each government to notify the Australian Competition and Consumer Commission (ACCC) when it enacts legislation that relies on section 51 of the TPA (which enables governments to exempt conduct from the prohibitions against anticompetitive behaviour in Part IV of the TPA).

### C. The Implementation Agreement

- Sets out the reform obligations covering national markets in electricity and gas, water reform and national road transport regulations.
- Provides for payments by the Commonwealth to the States and Territories where they achieve satisfactory progress with the implementation of the NCP and related reforms.

The NCP obligations did not require: privatisation, blanket deregulation, "free" markets, welfare cutbacks, contracting out, reduced social services, or a particular focus on markets, money and materialism. NCP did not prevent governments from increasing spending on welfare, increasing the level of government funded or subsidised social services, or retaining businesses in public ownership. It explicitly recognises a need for government intervention in markets, where this is justified.

Annexure 1 to this briefing paper further illustrates the NCP framework.

## The National Competition Council

In 1995, when the CoAG agreed to implement the NCP, they established the National Competition Council (**NCC**) to assist with the complex and ongoing process. The NCC is a policy advisory body which provides national oversight of NCP. It is not the role of the NCC to set reform agendas or implement reforms; these are the responsibilities of the various governments.

Although the NCC is funded by the Commonwealth Government, it is accountable to all Australian Governments. As a statutory body, the NCC is, importantly, independent of the executive arm of government.

The NCC has four main roles:

- assessment of governments' progress in implementing the NCP reforms and recommendations on competition payments to be made by the Commonwealth to the States and Territories;
- advice on the design and coverage of access rules under the national access regime;

- community education and communication covering both specific reform implementation matters and NCP generally; and
- other specific projects requested by Australian governments.

The NCC comprises five part time councillors with a variety of backgrounds from different parts of Australia. It is supported by a secretariat of approximately 20 staff, located in Melbourne.

In the context of delivering benefits to the Australian community, the NCC has set the following corporate goals:

- to facilitate timely implementation of effective and fair competition reforms by governments;
- to promote competition policy as an 'economic tool' for enhancing Australia's performance and productivity;
- to promote better use of Australia's infrastructure;
- to build community awareness of and support for NCP; and
- to ensure the NCC is a dynamic organisation, capable of providing a safe, healthy and professional work environment for its staff and developing their full potential.

## Reviews of the NCP

The NCP has undergone review on at least four occasions.

Sept. 1999	Productivity Commission released <i>The Impact of Competition Policy Reforms on Rural and Regional Australia (Report No. 8)</i> .
Feb. 2000	Federal Parliamentary Senate Select Committee on the Socio-Economic Consequences of the NCP released its report and recommendations: <i>Riding the Waves of Change</i> .
2000 and 2001	On 03.11.2000, the CoAG affirmed the importance of the policy and agreed to several measures to fine-tune implementation arrangements.  On 08.06.2001, the CoAG reaffirmed the importance of an open and competitive energy market in delivering benefits to households, small business and industry.
2003 and 2004	The main reviews of NCP issues conducted or commenced during 2003-04 were the Productivity Commission Review of the National Gas Access Code and the Productivity Commission Review of NCP arrangements. In addition, through the National Water Initiative the CoAG further developed the NCP water reform program.
Oct. 2004	Productivity Commission released a discussion draft of its Review of NCP Reforms: <i>Review of National Competition Policy Reforms, Discussion Draft, Canberra, October 2004</i> .

## NCP payments

An important feature of the NCP institutional framework is the competition payments made by the Australian Government to the States and Territories (on a per capita basis) for satisfactory progress in implementing the reform commitments. The payments recognise that, although the States and Territories are responsible for significant elements of NCP, much direct financial return accrues to the Australian government via increases in taxation revenue that flow from greater economic activity. The NCP payments are the means by which gains from reform are distributed throughout the community.

The NCC conducts assessments and advises the Treasurer on whether the States and Territories have achieved satisfactory progress and so meet the condition for receipt of payments. This is reported in the NCP assessments reports. The NCC has conducted assessments in 1997, 1999, 2001, 2002, 2003 and 2004.

Funds totalling about \$5.7 billion were allocated for competition payments over the period 1997-98 to 2005-06. Set out in Table 2.1, Annexure 2 is a table of competition payments over this time period. This funding level was developed by reference to the Industry Commission's estimates of the benefits of implementing the reform program.

The NCC has commented that competition payments (and by extension penalties for non-compliance) have been an important contributor to the success of the NCP:

Using competition payments to leverage reform outcomes in areas of State and Territory responsibility has proven highly effective... Reform would have been far slower and less comprehensive without competition payments. These payments (now at around \$800 million per year) may not be large relative to State and Territory budgets, but none the less represent a significant source of incremental funds.

In assessing the nature and quantum of any penalties that it recommends, the NCC takes into account the significance of the compliance breach, the extent of the State or Territory Government's overall commitment to NCP implementation and the effect of that jurisdiction's reform efforts on other jurisdictions.

Penalties recommended by the NCC, and imposed by the Treasurer, for 2002-03 are set out in Table 2.2 of Annexure 2. In total, they were equivalent to just under 25% of the competition payments allocated for that year (and about 5% of the total funding allocation over the 6 years to 2002-03). Queensland accounted for around a third of these total penalties, and Western Australia and New South Wales for around a quarter each. The Australian Government has also been notable for the extent and significance of its compliance breaches.

In the 2003 NCP assessment, there were three categories of penalties. They were:

- **Permanent deductions** which are irrevocable reductions in governments' 2003/04 competition payments for specific compliance failures.
- **Specific suspensions** which apply until specific pre-determined conditions or obligations are met, at which time the suspension is lifted and suspended 2003/04 competition payments released to the relevant jurisdiction. Suspensions of this type recognise that governments are taking action to comply but have not as yet completed that action. The NCC will re-address these matters as and when significant commitments are met, or reforms implemented. Where commitments are not made or met, or reform action is not implemented by the 2004 NCP assessment, the NCC is likely to recommend that the suspended 2003-04 competition payments be withheld permanently (that is, converted to a permanent deduction).
- **Pool suspensions** which apply to a pool of outstanding legislation review and reform compliance failures and relate to payments for 2003-04. The NCC will reassess progress with the pool of compliance failures in the 2004 NCP assessment. If satisfactory progress is made, the NCC may recommend that the suspension be lifted or reduced and the funds released to the relevant jurisdiction. If satisfactory progress has not been made, the NCC is likely to recommend that all or part of the suspension be converted to a permanent deduction for the 2003/04 competition payments and the deduction be ongoing.

In accordance with the original deadline set by the CoAG, 2002 was to be the last year for governments to complete the NCP legislative review and reform program. For the 2003 assessment, the NCC recommended that the Treasurer reduce or suspend payments to the States or Territories that had not fully implemented their NCP obligations. Because no jurisdiction had then completed its legislation review and reform program, the NCC's 2003 assessment contains a wide range of penalty recommendations on legislation review and reform matters.

In its 2004 assessment, the NCC recommended that Victoria, Tasmania and the ACT receive their maximum payments. Reimbursements of 2003/04 suspensions, totalling more than \$85.1 million were recommended for all States in recognition of the substantial progress made in the past 12 months. Suspensions of \$114.1 million and permanent deductions of \$26.2 million of 2004/05 payments were recommended where obligations remained outstanding. Table 2.2A of Annexure 2 sets out the payments and penalties for 2004/05 and reimbursements for 2003/04 for each state.

# Progress in Implementing the NCP

Much has been accomplished since the NCP was introduced in April 1995. A wide range of activities – including infrastructure services, agricultural marketing, professions, occupations, financial services, retail trade and water resource management, have undergone substantial change. In addition to the direct impacts, the NCP has also contributed to a more responsive and innovative business culture in the private and public sectors.

Nevertheless, implementation of the package of reform remains incomplete, reflecting the sheer size of the NCP agenda, differences in the required degree of reform and the approach adopted across jurisdictions, and the extensions to the original timetable for some initiatives.

## Extending the anticompetitive provisions of the TPA

Prior to the commencement of NCP, the TPA's coverage was limited by the scope of the Australian government's constitutional power. Thus State and Territory governments, GBEs, unincorporated entities and various other activities were generally exempt from the conduct provisions.

Extending coverage of the TPA to previously exempt government business activities and unincorporated enterprises was one of the earliest (and perhaps most straightforward) NCP reform initiatives. To give effect to this reform, the Australian Government amended the TPA in 1996 by inserting the Competition Code into the TPA to provide for the States and Territories to pass legislation to enact a modified version of Part IV, the Competition Code, in each of their jurisdictions. All States and Territories subsequently implemented the agreed legislation to take effect from July 1996.

## Reforms to public monopolies

Reform programs for the electricity, gas and water sectors that were previously (and in some cases remain) dominated by public monopolies, and which had been the subject of earlier CoAG agreements, were subsequently incorporated into the NCP. In addition to these specific commitments, Governments agreed to adhere to certain principles, outlined in the Competition Principles Agreement, should they choose to expose their other public monopolies – in areas such as railways, ports, airports, public transport, telecommunications and postal services – to competition or privatise them. The Competition Principles Agreement sought to establish the conditions necessary for effective competition in these markets. They cover four elements: structural reforms, competitive neutrality, prices oversight and third party access arrangements.

Structural reform commitments (many of which were well advanced before NCP) have resulted in extensive changes to the operations of GBEs in most jurisdictions. These businesses have either been corporatised, privatised and/or had their statutory monopoly protection removed. Many vertically integrated providers have been separated into competing businesses, either on an activity or regional basis, and regulatory functions have in most cases been transferred to independent authorities.

In addition, all jurisdictions have published competitive neutrality policy guidelines and established complaints handling officers. Similarly, each Government (where they had not already done so) has established independent prices oversight bodies to monitor and regulate monopoly service providers. The ACCC was given responsibility for setting and overseeing prices for monopoly businesses not under State/Territory control.

Also, a national third party access regime (administered by the NCC and ACCC) has been established, along with the host of industry specific access regimes which have been certified as "effective" (meaning they satisfy certain agreed criteria) under the TPA. Many of these industry regimes are governed by State/Territory legislation and are administered by their respective prices oversight bodies. They include regimes providing access to electricity distribution networks, gas pipelines, rail networks, shipping channels and ports. Federal regimes apply to the national electricity market and telecommunications, airports and postal facilities.

## Unfinished business in reforms to public monopolies

While substantial progress has been made in implementing NCP commitments, the NCC indicated that NCP requirements had not been satisfied in the cases of:

- Telstra, where the merits of structurally separating the local fixed network from its other businesses have not been reviewed;
- the Australian Wheat Board, where legislation continues to provide it with monopoly export powers. In addition, the NCC has pointed to some gaps in the application of competitive neutrality principles – for example, research activities in universities and public hospitals.

## Review of anti-competitive legislation

Under the Competition Principles Agreement, each jurisdiction agreed to list, review and, where appropriate, reform all legislation which restricts competition by 30 June 2000. This deadline was subsequently extended on 3 occasions, with the latest official deadline being 30 June 2004. The guiding principle was that legislation should not restrict competition unless it can be demonstrated that the:

- benefits to the community as a whole of the restriction outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

Legislation Review Schedules were published by each jurisdiction in 1996, with around 1,800 individual pieces of legislation listed for scrutiny. The legislation was subsequently divided by NCC into priority areas and non priority areas. According to the NCC's latest published tranche assessment, while considerable progress had been made, no Government had fully implemented its review and reform obligations at that time. At 30 June 2003, just over half the priority reviews had been completed – that is, the reviews had been finalised and legislation passed to implement reforms consistent with the guiding principles. The completion rate for non priority areas was around 80 per cent. However, further review and reform activity has since occurred. Table 2.3 of Annexure 2 to this briefing paper is a table setting out the overall outcomes from the review and reform of legislation.

### Unfinished business in the legislation review program

The NCC has noted that for most of the outstanding reviews, reforms were either before Parliament or the necessary legislation was being drafted and that, in these cases, the reforms were likely to be completed in a relatively short time. That said, a number of reviews have failed the NCC's assessment on the basis that adequate "public interest cases for maintaining restrictions on competition have not been provided". Concerns have also been raised regarding the adequacy of review processes for new and amended legislation restricting competition. Specifically, NCC has contended that there has sometimes been a failure to demonstrate a net public benefit and/or alternative means of achieving legislative objectives.

## Related infrastructure reforms

All Governments commenced reforms in the key infrastructure sectors of electricity, gas, road transport and water in the late 1980s. They included:

- the 1992 agreement by Australian Transport Ministers on National Road Transport Reform to improve efficiency and safety, and reduce the costs of regulation;
- the 1993 agreement between the Australian, New South Wales, Victorian, Queensland, South Australian and ACT Governments to form a competitive inter-state electricity market;
- the 1994 Council of Australian Governments Agreement to provide for free and fair trade in gas between and within the States and Territories; and
- the 1994 Council of Australian Governments Agreement to implement a framework for the efficient and sustainable reform of the Australian Water Industry.

## Electricity

The cornerstone of reforms in the sector was the concept of establishing a fully competitive National Electricity Market (**NEM**) in Southern and Eastern States. Although there are still some important areas of unfinished business in particular jurisdictions, most Governments have met their key obligations in this area. The NEM became operational in December 1998 (although as it has transpired, inter connection of transmission networks to provide for the sharing of reserved capacity by most participating jurisdictions has not proved to be particularly effective). Third party access arrangements for network infrastructure have also been established in each participating jurisdiction. Table 2.4 of Annexure 2 sets out the progress in electricity reform, as at June 2004.

Competition has been introduced into the generation and retail sectors by permitting eligible users to negotiate directly with suppliers of their choice. All large retail customers are now able to choose their supplier. Retail contestability for domestic consumers is in place in all jurisdictions except for Queensland.

Structural separation of previously vertically integrated electricity providers has been completed in all NEM jurisdictions, with most opting to maintain Government ownership of the separated entities under a corporatised governance model. However, Victoria has fully privatised its electricity assets, while South

Australia has chosen a private sector leasing arrangement.

While there has been considerable progress in a electricity reform, it has become clear that the original objectives of a fully competitive national electricity market has not been achieved. For a range of reasons, including inadequate transmission links, the regional markets have yet to be effectively transformed into a national market.

## Gas

Gas market reform has centred around the development of a national gas market characterised by more competitive supply arrangements. The majority of these reforms have been implemented, with only a few outstanding issues for particular jurisdictions. Structural separation of vertically integrated suppliers has been completed and all Governments have introduced legislation to apply the Gas Code to their jurisdictions (although the Queensland regime has been assessed by the NCC as not being “effective”). All Government owned gas utilities have been corporatised and, in many cases, privatised. Constraints on interstate trade in gas have been removed, contributing to a doubling of transmission pipeline investment between 1989 and 2001. In addition, legislation to provide for full retail contestability is in place in most jurisdictions (the main exception being Queensland which has chosen not to implement this reform component on the basis of a cost-benefit assessment). Table 2.5 of Annexure 2 sets out the progress in gas reform, as at June 2004 for each State and Territory.

The recent CoAG Energy Market Review expressed concerns about the impact on new investment of regulatory assessments in the Gas Access Regime and a level of competition in upstream gas supply. Similarly, in its report on the Gas Access Regime, the Productivity Commission found that the access arrangements could potentially discourage or distort investment in gas infrastructure.

## Road transport

In 1992, CoAG agreed on a national approach to Road Transport Reform aimed at improving transport efficiency and road safety and reducing the administrative and compliance costs of regulation. These commitments pre-date the NCP and, following their inclusion in the package, have been modified and extended. Implementation of the NCP Road Transport Reforms is almost complete. Outstanding issues

mainly relate to specific licensing and registration scheme initiatives in three jurisdictions.

Despite this progress, concerns have been raised by the Road Transport Industry about reform inconsistencies and shortcomings in the reform package. The NCC claims the reform agenda had not comprised all of the initiatives needed to develop a nationally consistent regulatory regime. In this context, a number of reform proposals have been put forward by the National Road Transport Committee.

## Water

Key initiatives in this area have included: institutional reforms, pricing reforms, investment reforms, allocation and trading reforms and ground water supplies and initiatives aimed at improving water quality. The NCC claim all Governments are making progress in implementing their water reform commitments, although at different rates and using different approaches. The NCC believes this reflects the complexity of the reforms, the diversity of administrative and legislative environments across jurisdictions, differences in the health of river systems and different stakeholder groups. For these reasons, the original timetable for completion has been extended twice with completion of the agenda now due by 2005.

Urban Water Reforms are, for the most part, more advanced. Various institutional reforms have also been implemented to increase the commercial disciplines on, and the accountability of, those entities delivering water and sewerage services, with most jurisdictions having corporatised their Urban Water Authorities. In some particular areas in rural water, significant progress has also been made. All jurisdictions have enacted legislation separating water entitlements from land title and introduced arrangements for ecological appraisal of proposed new water schemes.

### Unfinished business in water

Progress in implementing other rural water reforms – including pricing that incorporates a component for the environmental impacts of water storage and distribution, environmental water allocations, property rights and trading of water entitlements – has in most cases been slow and variable. In these areas, significant differences have emerged between jurisdictions in the interpretation of, an approach to implementing some reforms. Table 2.6 of Annexure 2 sets out the progress in water reform, as at May 2004 for each State and Territory.

# Australia's Recent Economic Performance and the Role of NCP

It was anticipated that NCP would enhance Australia's economic performance and community living standards by increasing the incentives for enterprises (both government and private) to be efficient, innovative and responsive to the needs of consumers. Previous quantitative modelling by the Productivity Commission of the "outer envelope" of potential improvements from implementing NCP reforms, yielded estimates of GDP gains in the long term of up to 5.5 per cent.

Australia's economic performance has improved markedly since the early 1990s on a number of measures, and has exceeded that of many other developed countries. According to the Productivity Commission, a key feature of this improved performance was a surge in productivity growth. During the latest productivity cycle, multifactor productivity – a measure of the efficiency with which both labour and capital are used – grew at more than double the rate in the previous cycle. Notwithstanding difficulties in establishing causality, the Productivity Commission has found a range of indicators confirms that micro-economic reform in general, and NCP in particular, have been principal contributors to the improvement in Australia's productivity performance and have delivered significant benefits to the community. Quantitative modelling by the Productivity Commission indicates that recent productivity improvements and price changes in six key infrastructure sectors have generated a permanent increase of 2.5 per cent in Australia's GDP (around \$20 billion). NCP reforms have been an important contributor to the observed productivity improvements and price changes. Moreover, the full gains from reform are yet to be realised.

# Implementation of Similar Structure for Sustainable Growth Initiatives

Where the task force is able to identify particular initiatives for sustainable growth, it will be necessary to formulate an approach to executing the initiatives. In our view, the task force should consider the implementation of NCP as a model upon which it could base implementation of such initiatives.

The NCC has attributed the success of the NCP model to three key interrelated aspects of Australia's institutional framework:

## 1 An agenda agreed by all governments that outlines the reform commitments with a practical degree of specificity

The NCP was adopted unanimously; a product of all Australian governments. Governments' ownership of the NCP agenda has been a major factor in the program's success, particularly given Australia's brand of fiscal federalism. Another major strength of the NCP agreements is their reliance on the 'spirit' of the reforms and the flexibility afforded to governments in meeting their commitments and to the NCC in assessing progress.

## 2 A fearless and independent body responsible for negotiating, monitoring and reporting on reforms

Competition payments alone would not have been sufficient to bring about the observed benefits. An independent body that can clarify reform commitments, focus governments' attention on those commitments and facilitate reform is also important. The requirement on each jurisdiction to publish an NCP annual report has helped to maintain reform momentum.

## 3 The provision of appropriate incentives including financial payments

The NCC uses the incentives available under the NCP program to encourage governments to complete their reform commitments. While penalty recommendations have been used by the NCC as instruments of last resort, using competition payments to leverage reform outcomes in areas of State and Territory responsibility has proven highly effective. The involvement of an independent body, the NCC, to recommend on the release of funds has enhanced this effectiveness. The NCC's view is that reform would have been far slower and less comprehensive without competition payments. Apart from the magnitude of the funding, tying performance to financial rewards has

enabled governments to eschew pressure from lobby groups by highlighting the cost of failing to meet their NCP commitments.

## Improving the NCP process

The NCC has identified five areas in which the NCP process could have been improved.

### 1 Specificity of review processes and reform obligations

The independence of some legislation reviews has been a concern because the NCP does not detail the requirements of the review processes. Similarly, elements of the NCP would have benefited from greater clarity in the specification of the required reforms. The lack of clarity has permitted a minimalist approach to reform in some cases. While the flexibility provided by the NCP agreements is an asset compared with a black letter template approach, the balancing act is a fine one. To assist achievement of effective reform outcomes, agreements need to be unambiguous and commitments clearly defined.

### 2 Transparency

The NCP does not require legislative review reports to be made public.

While the NCC has engaged constructively with governments in all reform areas, a formal consultative forum would have been useful.

### 3 Incentives for the Australian government

The Australian Government is a party to the NCP yet does not receive competition payments (note though, that it is assumed to receive significantly increased taxation revenues from increased economic activity). The absence of a direct financial incentive/constraint on the Federal government creates an inconsistency in how jurisdictions are treated when they fail to comply with their commitments. Apart from

being found not to comply, the Australian Government has no direct incentive to progress reforms. Its relatively poor performance has been noticed by States and Territories subject to penalty recommendations.

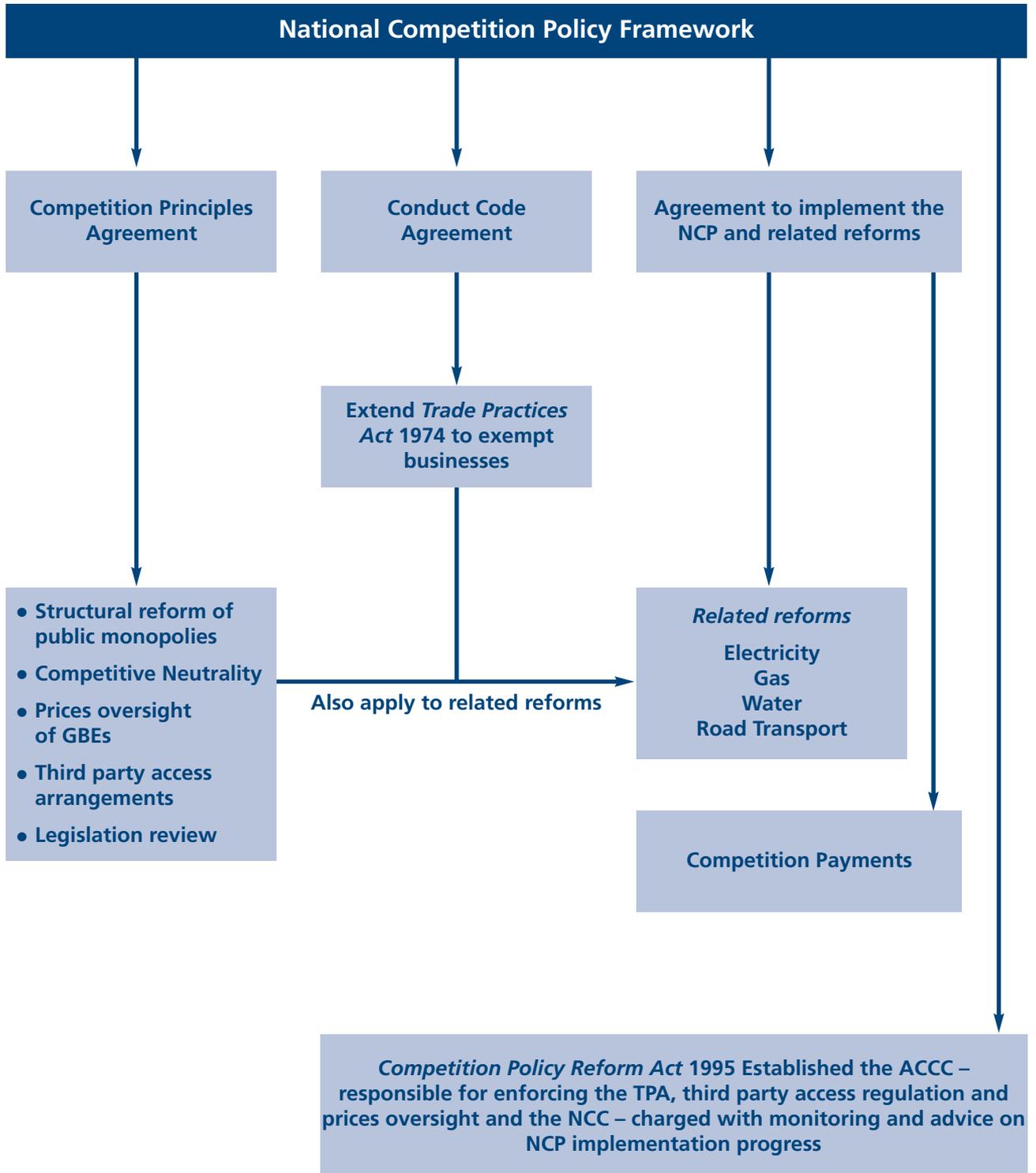
#### **4 National reviews versus piecemeal jurisdictional reviews**

Both national reviews and State and Territory based reviews have advantages and disadvantages. The potential benefits of national reviews are reduced duplication of effort and the scope for greater consistency. These benefits accord with the notion of Australia as a 'single market' in a global environment. On the other hand, policy competition can also provide benefits. A standardised national reform model carries a risk of large scale regulatory failure, whereas a competitive model facilitates policy learning. The NCC encountered areas in which innovative approaches to one jurisdiction have been adopted by other jurisdictions. The NCP assessment process also encourages slow moving jurisdictions where they see reforms in other States delivering benefits.

#### **5 Phasing transitional matters**

The NCC has identified a perception in the broader community that the impacts of the NCP have been uneven, with the benefits accruing (mostly) to urban centres and the costs being borne (mostly) by rural and regional areas. The Productivity Commission considered these perceptions to be unfounded, however, the removal of some regulatory privileges can have differential geographic impacts. The NCC is of the view that explicit recognition of the need for change management would be beneficial in any future reform agreements.

# Annexure 1: National Competition Policy Framework



## Annexure 2

**Table 2.1 Competition payments, 1997-98 to 2005-06 (\$ million)**

Figures for 1997-98 to 2002-03 are final budget outcomes. Figures for 2003-04 to 2005-06 are estimates.

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
NSW	127	139	210	156	243	252	257	262	269
Vic	93	102	152	115	180	182	190	194	199
Qld	74	82	119	73	148	139	146	151	156
WA	38	42	62	46	71	72	75	77	79
SA	34	38	54	36	56	57	59	59	61
Tas	13	14	19	11	17	18	18	18	19
ACT	6	7	11	8	12	12	13	13	13
NT	11	13	14	5	8	8	8	8	8
<b>Total</b>	<b>396</b>	<b>437</b>	<b>640</b>	<b>448</b>	<b>733</b>	<b>740</b>	<b>765</b>	<b>782</b>	<b>802</b>

**Table 2.2 Competition payment penalties for 2002-03**

<b>New South Wales</b>	Permanent deduction of 5 per cent for non-compliance in chicken meat legislation (\$12.86 m).
	Permanent deduction of 5 per cent for non-compliance in liquor regulation (\$12.86m).
	Pool suspension of 10 per cent for outstanding legislation review items (\$25.72m).
<b>Victoria</b>	Pool suspension of 5 per cent for outstanding legislation review items (A\$9.48m).
<b>Queensland</b>	Permanent deduction of 5 per cent for non-compliance in liquor regulation (\$7.31m).
	Specific suspension of 10 per cent for non-compliance in electricity (\$14.62m).
	Specific suspension of 15 per cent for non-compliance with obligations in respect of full retail contestability for electricity consumers (\$21.93m).
	Pool suspension of 10 per cent for outstanding legislation review items (\$14.62m).
<b>Western Australia</b>	Permanent deduction of 10 per cent for non-compliance in retail trading hours legislation (\$7.52m).
	Permanent deduction of 5 per cent for non-compliance in liquor regulation (\$3.76m).
	Permanent deduction of 5 per cent for non-compliance in potato marketing (\$3.76m).
	Specific suspension of 10 per cent for lack of water pricing transparency (\$7.52m),
	Specific suspension of 5 per cent for non-compliance in egg marketing (\$3.76m).
	Pool suspension of 20 per cent for outstanding legislation review items (\$15.04m).
<b>South Australia</b>	Permanent deduction of 5 per cent for non-compliance in chicken meat legislation (\$2.93m).
	Permanent deduction of 5 per cent for non-compliance in liquor regulation (\$2.93m).
	Specific suspension of 5 per cent for non-compliance in barley marketing (\$2.93m).
	Pool suspension of 15 per cent for outstanding legislation review items (\$8.78m).
<b>Tasmania</b>	Pool suspension of 5 per cent for outstanding legislation review items (\$0.91m).
<b>ACT</b>	Pool suspension of 10 per cent for outstanding legislation review items (\$1.25m).
<b>Northern Territory</b>	Permanent deduction of 5 per cent for non-compliance in liquor regulation (\$0.38m).
	Pool suspension of 15 per cent for outstanding legislation review items (\$1.14m).

Source: Costello (2003)

**Table 2.2A Competition payments and penalties for 2004-05 and reimbursements for 2003-04 (\$million)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
<b>2003-04</b>								
Reimbursements	25.4	9.4	29.2	14.9	2.9	0.9	1.2	1.1
<b>2004-05</b>								
Maximum available payments	260.1	192.2	150.8	76.8	59.1	18.6	12.4	7.7
Permanent deductions	-	-	(7.5)	(15.4)	(3.0)	-	-	(0.4)
Suspensions	(52.0)	-	(30.2)	(23.0)	(8.9)	-	-	-
<b>Actual payments</b>	<b>233.6</b>	<b>201.6</b>	<b>143.3</b>	<b>53.5</b>	<b>50.4</b>	<b>19.8</b>	<b>13.6</b>	<b>8.4</b>

**Table 2.3 Overall outcomes from the review and reform of legislation**

Government	"Priority" legislation	"Non-priority" legislation	Total legislation	"Priority" legislation complying	"Non-priority" legislation complying	Total legislation complying
	Number	Number	Number	Per cent	Per cent	Per cent
Australian	57	68	125	33	66	51
New South Wales	118	98	216	69	79	73
Victorian	91	119	210	78	83	81
Queensland	118	60	178	61	92	71
Western Australian	117	157	274	31	54	44
South Australian	75	96	171	37	82	63
Tasmanian	100	138	238	77	90	84
ACT	78	178	256	59	97	85
Northern Territory	57	40	97	47	83	62
<b>All jurisdictions</b>	<b>811</b>	<b>954</b>	<b>1765</b>	<b>56</b>	<b>81</b>	<b>69</b>

Includes the stock of legislation identified by each jurisdiction in its original legislation review schedules, jurisdictions' periodic additions and existing, amending and new legislation containing restrictions on competition identified by the NCC. Excludes most water, electricity, gas and road transport related legislation.

Source: NCC (2003b, p.4.14)

**Table 2.4 Progress in electricity reform, as at June 2004**

Reform	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Structural separation	✓	✓	✓	☐	✓	✓	✓	✓
Introduction of relevant NEM arrangements	✓	✓	✓	Na	✓	☐	✓	Na
Third party access	✓	✓	✓	✓	✓	✓	✓	✓
Independent access and pricing regulators	✓	✓	✓	✓	✓	✓	✓	✓
Full retail contestability	✓	✓	x	☐	✓	☐	✓	☐

☐ = implementing

na = not applicable

Sources: Commission assessment based on information contained in the NCC (2003b) tranche assessment and NCC (personal communication).

**Table 2.5 Progress in gas reform, as at June 2004**

Reform	NSW	VIC	QLD	WA	SA	TAS <sup>a</sup>	ACT	NT
Third party access regime in place	✓	✓	✓	✓	✓	✓	✓	✓
Access regime certified as effective	✓	✓	x <sup>b</sup>	✓	✓	☐	✓	✓
Removal of legislative / regulatory restrictions <sup>c</sup>	✓	✓	✓	✓	✓	✓	✓	✓
Institutional reform (eg structural separation and corporatisation)	✓	✓	✓	✓	✓	na	✓	✓
Independent access and pricing regulators	✓	✓	✓	✓	✓	✓	✓	✓
Full retail contestability	✓	✓	x	✓	✓	x	✓	✓

☐ = implementing

na = not applicable

a A natural gas pipeline to Tasmania only became operational in 2002 and the gas industry in Tasmania is in its infancy. While legislation for an access regime is in place, Tasmania has not applied to have this legislation certified by the NCC.

b The NCC found that the Queensland gas access regime did not meet the requirements of effectiveness under Part IIIA of the Trade Practices Act. This finding and recommendation against certification is with the Federal Treasurer.

c While most review and reform of legislation relating to natural gas has been completed, the NCC noted that the review and reform of legislation relating to offshore and onshore petroleum acreage management legislation (upstream issues) had not been completed in most jurisdictions.

Sources: Commission assessment based on information contained in NCC (2003b) tranche assessment and NCC (personal communication).

**Table 2.6 Progress in water reform, as at May 2004**

Reform	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	MDBC
<b>Pricing – urban water</b>									
Full cost recovery	✓s	✓	✓s	☐		✓s	✓	✓	na
Two-part tariff	✓s	✓	✓s	✓	✓		✓	✓	na
Cross subsidies removed, others made transparent	✓	✓	✓	✓	✓		✓	✓	na
<b>Pricing – rural water<sup>a</sup></b>									
Full cost recovery			✓s		na	✓	na	na	
Two-part tariff	✓	✓	✓		na	✓	na	na	✓
Cross subsidies removed, others made transparent			✓			✓	na	na	
Investment appraisal	✓	✓	✓	✓	✓	✓	✓	✓	na
<b>Institutional reform</b>									
Separation of service provision and regulatory roles	✓	✓	✓	✓	✓	✓	✓	✓	✓
Integrated catchment management approach	✓s	✓s		✓s	✓s	✓s	✓s	✓s	✓
Commercial business focus	✓	✓	✓	✓	✓	✓	✓	✓	✓
Irrigation scheme management devolution	✓	✓	✓	✓s	✓s	✓s	na	na	na
<b>Entitlements &amp; trading</b>									
Legislation separating water entitlements from land title	✓	✓	✓	✓	✓	✓	✓	✓	na
Licenses converted/ allocations defined	✓s	✓s	✓s	✓	✓s	✓s	✓	✓	na
Trading in water rights						✓			na
<b>Environment</b>									
Environmental allocations									
Stressed and over-allocated rivers			na	na	na	na	na	na	
Other systems surface/ groundwater					✓s	x	✓		na
Water quality management	✓s	✓s			✓s	✓s		✓s	na
Landcare practices (high value rivers)	✓	✓	✓	✓	✓	✓	✓	✓	na
Ecological appraisal (new rural schemes)	✓	✓	✓	✓	✓	✓	✓	✓	na

a These rural water pricing reforms apply to government owned water businesses. The ACT and the Northern Territory do not have government owned rural water businesses. South Australia has privatised many of its former government owned irrigation businesses and intends to privatise the remainder.

✓ = Fully implemented; ✓s = substantially implemented; ☐ = implementing; x = little or no progress; na = Not applicable; MDBC = Murray Darling Basin Commission.

Source: NCC (sub.71)

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