



APEC High Level Conference on Structural Reform

The role of competition policy in structural adjustment *An overview of recent Australian structural reforms*

Tokyo, 8-9 September 2004

Joe Dimasi
Executive General Manager – Regulatory Affairs Division
Australian Competition and Consumer Commission
9 September 2004

Introduction

During the 1990s, Australia embarked on an ambitious micro-economic reform program embodied in the National Competition Policy (NCP). This reform program was a response to concerns about Australia's poor economic performance compared against other developed countries. Despite microeconomic reforms to Australia's economy in the 1980s, a greater emphasis on fiscal responsibility and a commitment by the central bank to target inflation, Australia's productivity performance continued to compare poorly to its international peers.

By 1990, Australia's GDP per capita and GDP per hour were ranked 16th out of OECD member countries. In response, Australian governments agreed to examine a national approach to microeconomic reform in order to improve Australia's economic performance. After an independent review, known commonly as the Hilmer review,¹ Australian governments agreed in 1995 to a NCP reform package.

As the title of the reforms suggests, their central focus was competition. More specifically, their focus was upon the economy-wide application of law addressing anti-competitive conduct, and the removal of structural and legislative impediments so as to facilitate more competition in the non-traded goods sector. Competition was not pursued for its own sake, but rather effective competition was recognised as a means of enhancing community welfare by promoting a more efficient use of resources, thus providing greater returns to producers and higher real wages.

After a decade, it is now possible to step back and review some of the outcomes of these reforms. This paper presents an overview of the NCP reforms and their outcomes from the perspective of the Australian Competition and Consumer Commission (ACCC). The ACCC is responsible for enforcing the competition law and is the national utility regulator. The paper illustrates the strong link between the reforms and broader competition policy objectives.

Overview of the National Competition Policy reforms

The reforms initiated by Australian governments were wide ranging in scope. Australia had a history of legislation restricting anti-competitive conduct. However, the Hilmer review and Australian governments recognised that competition policy was much broader than legislation governing market conduct, and encompasses all policy dealing with the extent and nature of competition in the economy. Given the breadth of the reforms, they are best considered broadly by their intended outcome. According to the Hilmer review these intended objectives were:

- The creation of an economy wide competition law

¹ The Independent Committee of Inquiry into National Competition Policy, chaired by Professor Fred Hilmer, was commissioned in 1992 to propose a National Competition Policy that would support an open, integrated, domestic market for goods and services.

- Competitive neutrality between government and private enterprises
- Removal of regulatory restrictions to competition
- Structural reform of public monopolies
- Access to essential facilities
- Prices oversight to constrain monopoly pricing

Each of these objectives can be linked to the broader policy of enhancing market forces and economic efficiency.

Federal nature of reforms

Australia is a federation with both state and commonwealth governments, with the powers of the Commonwealth government defined under a constitution. The economy wide reforms envisaged by the NCP required coordination across these various levels of government. The difficulties inherent in such a reform process are apparent and highlight the significance of some of the reforms.

The creation of an economy wide competition law

Laws designed to ensure that competition is not undermined by firms engaging in anti-competitive conduct are a common feature of many economies. In Australia, these rules have been embodied in the *Trade Practices Act 1974 (TPA)*. The TPA prohibits various anti-competitive agreements, the misuse of market power, and certain mergers and acquisitions.

The reforms gave these laws an economy-wide application. Formerly, due to constitutional law issues, these laws did not apply to state owned business enterprises or unincorporated associations.

Economy-wide application enables a consistent and uniform application of competition law. This creates a level playing field that fosters competition across all forms of business enterprise and not providing a regulatory benefit to a particular business class.

Despite the economic benefits of a level playing field across all sectors of the economy, governments recognised that there may be situations where competition benefits may not be sufficient to offset other social costs. In these circumstances the TPA allows for authorisation of conduct that would otherwise be considered anti-competitive. State governments committed in principle not to provide legislative exceptions to the economy-wide application of the TPA. States made agreed to make the process of providing exemptions more transparent by notifying the Commonwealth of any legislative exemptions.

Competitive neutrality between government and private enterprises

To create a more level playing field, policy makers recognised that more was needed than simply applying the TPA to all enterprises. In markets where government businesses compete with private businesses, governments could confer financial

advantages upon their own businesses. Hence, despite neutrality at law, private businesses might suffer a competitive disadvantage. When operating in markets where private operators are present, governments agreed to a set of competitive neutrality principles. These principles expressly did not apply to non-business, non-profit activities of government businesses.

These principles included charging cost reflective prices, adopting corporate models, paying or making allowances for government taxes and commercial borrowing rates, and complying with the same regulations that apply to private businesses. Governments have established state and federal complaints bodies to receive complaints and undertake investigations about whether Australian government businesses are complying with competitive neutrality principles.

Competitive neutrality was important as governments were increasingly removing themselves from the role of becoming the direct provider of services and were contracting with private operators to provide these services. This created a greater prospect of private enterprise and government entities competing to provide the same service.

Removal of regulatory restrictions to competition

Policy makers also recognised that while an economy-wide competition law could protect existing competition, there may be regulatory barriers to competition in a market. For example, legislated monopolies for public utilities, statutory marketing arrangements for many agricultural products and licensing arrangements for various professions restrict the entry of competitors into various markets. Governments agreed to a systematic review of existing legislation and removal of legislation that restricts competition, unless it could be shown that the benefits as a whole outweighed the costs and restricting competition was the only way to achieve those benefits.

Structural reform of public monopolies

Similarly, governments recognised that industry structure may in some cases restrict the emergence of competition. For example, gas and electricity utilities in Australia were traditionally vertically integrated, and in many cases state owned monopolies. While an economy wide competition law can protect competition, it cannot create competition in industries that lack a competitive market structure. Governments agreed to structural reform of public monopolies to separate the contestable and non-contestable elements of vertically integrated government owned businesses.

While the policy did not require governments to privatise their business activities, the policy required a transparent process to identify functions or activities that should stay with government, if the business was privatised or corporatised. For example, regulatory functions should not be administered by private companies and were removed from entities to be privatised.

Access to essential facilities

While removing regulatory and structural impediments to competition created the necessary preconditions for the emergence of competition in many public monopolies, governments recognised that competition would still not be possible in markets with

‘natural monopoly characteristics’. For example, it is not commercially feasible for an entrant into the telecommunications market to replicate the entire telephone line network. To be able to compete in the broader telecommunication market, new entrants need access to existing infrastructure.

Governments recognised that an economy wide competition law would not achieve this objective and agreed to a national third party access regime for facilities that could not be economically duplicated and were of national significance. The regime provided for access to infrastructure on terms that were ‘fair and reasonable’. The purpose of this regime was to create competition in industries dependent upon that infrastructure, not the infrastructure itself. This could be a particular problem where infrastructure owners also own businesses in dependent markets. These businesses have an incentive to restrict access to the infrastructure asset to favour their business in the related market.

Prices oversight to constrain monopoly pricing

Similar to the issue of access, in markets that are not contestable, businesses may have the ability to charge prices above competitive market prices for extended periods of time. In these markets an economy wide competition law will not constrain ‘monopoly pricing’. Governments recognised this and regulation has been introduced to constrain pricing in a number of industries. These regulations often accompanied access provisions as ‘natural monopolies’ face both problems. Again, the purpose was not to create competition in the infrastructure industry, but rather to preclude monopoly pricing from restricting the emergence of competition and more efficient outcomes in dependent industries.

Establishment of new institutions

The National Competition Policy included institutional reforms that created two new bodies, the ACCC and the National Competition Council (NCC).

The ACCC was not an entirely new body and was formed through the merger of the commission responsible for enforcing the competition law, the Trade Practice Commission, and the authority that had responsibility for overseeing prices, the Prices Surveillance Authority. The ACCC is the single independent body responsible for the economy wide administration and enforcement of the competition law. A single body creates consistency in the application of competition law. Additionally, it allows for the accumulation and sharing of expertise on competition matters within that body.

The ACCC also has responsibility for the administration of a number of the industry specific access regimes created by the reforms. A single entity that administers competition law and industry regulation is an institutional structure that is somewhat unique to Australia. A single body allows for the sharing of knowledge across the two functions and ensures that the two forms of regulation, that ultimately have the same objective of facilitating competition, do not cross purposes. There are also moves to further improve the efficiency and consistency of regulation across industries by creating a single energy regulator within the ACCC to administer the regulation of the electricity and gas markets.

The NCC was a new body that undertook a new task. The NCC was the independent arbiter responsible for monitoring compliance with the NCP reforms. It was also

responsible for providing policy advice on the implementation of reforms and the regulation of industries. An independent arbiter was important for monitoring compliance, as the benefits of the reforms were perceived to flow to all states whether they implemented the reforms or not.

Industry specific reforms

These economy wide reforms were accompanied by a number of sector specific reform initiatives. In particular, sector specific structural reform and access regulation were introduced into a number of industries as part of the reform of public monopolies. These reforms were undertaken under the national access law to ensure consistency throughout the economy.

The ACCC is responsible for access regulation of aspects of the electricity, gas, telecommunications and rail industries. These industries provide good illustrations of the industry specific reforms.

Electricity reforms

Historically, the electricity industry was state-based and publicly owned. Each state was largely self-sufficient in terms of generation. There was excess generation capacity in each of the states with interconnection limited to Australia's two largest states, New South Wales and Victoria. The infrastructure for generating, transporting and retailing electricity was vertically integrated.

As a result, governments agreed to:

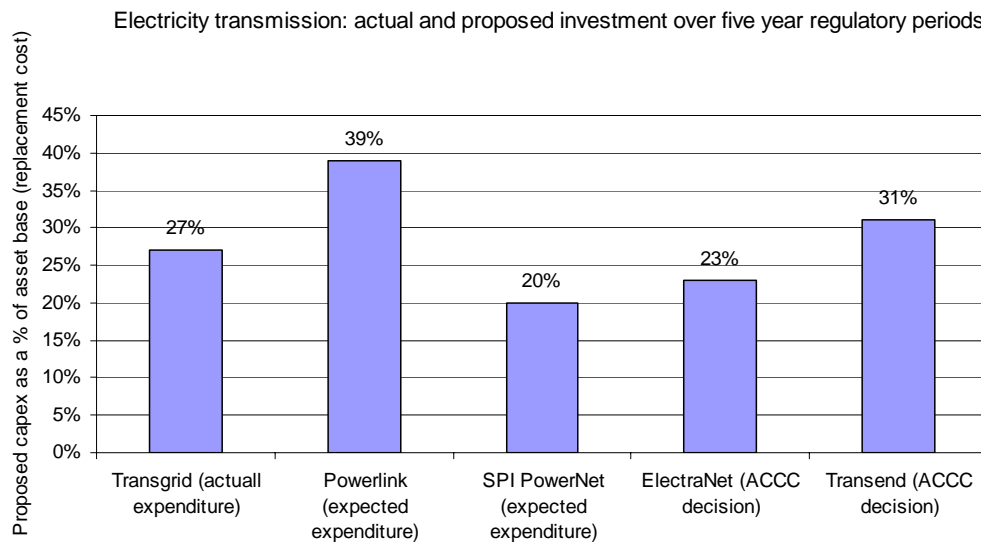
- placing utilities on a commercial footing through corporatisation
- vertically separating generation, transmission, distribution and retail businesses, and 'ring-fencing' these businesses from other activities
- allowing for customer choice of supplier through full retail contestability (FRC)
- implementing a system of third party access to transmission and distribution infrastructure on fair and reasonable terms
- establishing a wholesale electricity trading market known as the 'National Energy Market'

Overall electricity prices have declined in real terms since the creation of the National Energy Market. The two largest states of New South Wales and Victoria have experienced reductions of around 50 per cent in wholesale prices, the fastest growing northern state, Queensland, has experienced reductions of around 14 per cent, while South Australia, the smallest state in the National Energy Market, has experienced increases in wholesale prices. Each of the states in the National Energy Market has price controls for retail customers. Retail prices have, on average, remained fairly constant in real terms, but have fallen for some of the larger business customers.

The cost of energy and access to electricity infrastructure affects the competitiveness of users in all sectors of the economy. Lower, more competitive prices resulting from the reforms have helped industries compete in domestic and international markets, with beneficial outcomes for economic growth and employment. Australian electricity prices are among the lowest in the OECD.

A recent study using a general equilibrium model² found that the net present value of increases to GDP from access regulation of the electricity and gas industries (net of avoidable costs) were between A\$2.2 bn and A\$11 bn over the time period 1998-99 to 2012-13. Ninety per cent of the aggregate benefits were expected to be attributable to electricity access regulation, due to the relative sizes of the industries.

Investment in electricity transmission has been high over the last few years and substantial developments are either underway or planned. Over this decade transmission companies will spend around A\$3.7 bn on new regulated assets, adding some 40 per cent to the transmission asset base that existed prior to the reforms. This is illustrated in the graph below that shows the proposed capital expenditure as a percentage of the asset base of regulated electricity transmission entities.



Gas industry

Historically, the gas industry was state based with supply to demand centres typically met by a single basin through a single set of pipeline infrastructure. The infrastructure for transporting gas to demand centres was publicly owned by various states and vertically integrated (across transmission, distribution and retail). Further, ownership of supply sources was highly concentrated.

Governments agreed to reforms to:

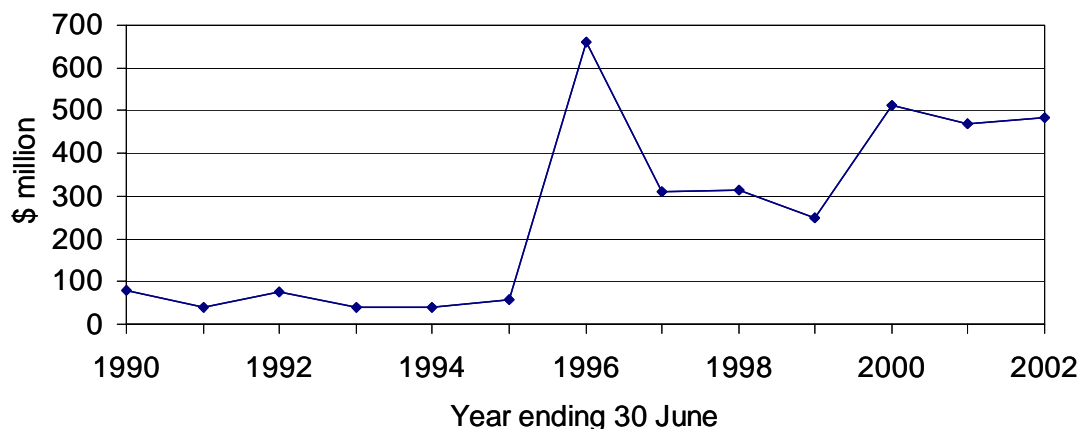
² ACIL Tasman (2004) *Impacts of Access Regulation: Gas and Electricity*.

- Remove legislative restrictions upon the interstate trade of gas
- Place gas utilities on a commercial footing through corporatisation
- Vertically separate transmission and distribution businesses and ‘ring-fence’ these businesses from the other activities of private gas utilities
- Implement a uniform national access regime for transmission pipelines
- an agreement to franchising principles that include an obligation to introduce full contestability of retail customers

The reforms have had pricing benefits. Tariffs for covered pipelines are typically lower than pre-regulation tariffs. Further, the study using a general equilibrium model discussed above indicated that prices of transmission and distribution could be significantly higher without regulation. Competitive pricing was pursued as a means of promoting competition in industries dependent upon the services of gas utilities, not to promote competition in the utility market itself. The study discussed above identified the net present value of increases to GDP from access regulation of the electricity and gas industries (net of avoidable costs) as between A\$2.2 bn and A\$11 bn over the time period 1998-99 to 2012-13. Ten per cent of the aggregate benefits were estimated as being attributable to the gas industry.

There has been some debate about whether these benefits come at the expense of investment. However, the evidence from the gas transmission industry is that investment remains strong despite price regulation. This is illustrated in the graph below that shows capital expenditure on gas transmission infrastructure between 1990 and 2002. It reveals that investment actually increased after regulation was introduced.

Gas transmission pipeline capital expenditure 1990-2002



Source: Australian Gas Association, *Gas Statistics Australia*, various editions

Telecommunications industry reforms

Historically, Australia’s telecommunications industry was dominated by a single government owned national carrier with a legislative monopoly. The telecommunications sector in Australia has been subject to gradual deregulation since

the late-1980s, with significant changes made in 1991 with the introduction of a duopoly in fixed line telephony and a triopoly in mobiles, and in 1997 with the establishment of full competition and revisions to the regulatory framework. In conjunction with increased contestability of the telecommunications sector, access regulation has been introduced to address market power in integrated upstream facilities that are necessary for downstream competitions. The access regulation is of particular significance to the telecommunications industry as structural reform of the horizontally and vertically integrated national carrier was limited.

These reforms, in particular the access regulation, have introduced new competitors and substantial investment into Australia's telecommunication market. New investment in the telecommunications sector has totalled more than A\$28.0 bn between 1997 and 2003,³ with A\$3.4 bn invested in Australian telecommunications infrastructure in 2001-02.⁴ By comparison, Telstra, the national carrier, has an annual turnover of around A\$20 bn. There has been a general downward trend in the prices of most call services. The ACCC estimates that between 1997-98 and 2001-02 the price of an average basket of telecommunications services fell by 20.7 per cent in real terms. Results of annual consumer satisfaction surveys suggest consumer satisfaction with competition and services is generally high.

The Australian Communications Authority has estimated that the 1997 changes to the telecommunications regulatory regime have led to net benefits to consumers of telecommunications services that, per household, have totalled between A\$600 to \$850.⁵ It also estimated that the economy is A\$10 billion larger than it would have been without these reforms. The industry's output is estimated to be 75 per cent higher in 2001-02 than if reforms had not been implemented.

Rail industry reforms

Substantial structural reform to the rail industry occurred during the 1990s through a number of inter-governmental agreements. Australia's interstate track network was state based, with differences between states in the operation of these networks restricting competition across the entire interstate network. As an example, track widths varied between states making the operation of a rail company across the entire network difficult.

The reforms established a single corporation responsible for the management and operation of Australia's interstate rail network. Reforms also introduced:

- vertical separation of rail ownership from above rail businesses of some government entities

³ Telstra, 1997 – 2003, various annual reports

⁴ ACCC (2003) *Emerging markets structures in the telecommunications sector*.

⁵ Allen Consulting Group (2002) *Benefits Resulting from Changes in Telecommunications Services*

- corporatisation and privatisation of some government entities
- co-regulation of safety across states and mutual recognition of accreditation
- improving uniformity of technical standards and operating practices
- implementing access regimes and ring fencing to cover various track networks.

Vertical separation and an access regime have facilitated above rail competition on the interstate rail network.

Over the past five years, above rail competition (as well as intermodal competition) appears to have driven technical efficiency improvements in the haulage of interstate freight. Examples of productivity improvements are expanded train lengths and heavier axle loads. In 2002-03, train lengths increased by approximately 5-6 per cent on the east-west corridor.⁶ This appears consistent with reports that intermodal efficiency (gross mass per train) improved by 30 per cent over the past five years, while average real access freight revenue yields have fallen by over 20 per cent. Rail volumes have improved. Despite falling grain volumes, gross tonne kilometres have grown, on aggregate, by 14 per cent over the past three years. Moreover, volumes on the east-west corridor increased by 6.7 per cent in the March 2004 quarter on the same period in 2003 and almost 16 per cent on the March 2002 quarter.

Outcomes of National Competition Policy Reforms

While a causal link is inherently difficult to establish, NCP and related reforms have coincided with the most consistent and sustained period of economic growth in our history. GDP per person has grown by 2.5 per cent a year since 1990 compared with the OECD average in of 1.7 per cent. This has brought Australia's OECD ranking from the low of 16th in 1990 to eighth in 2002. Australia's Productivity Commission estimates that household income is A\$7,000 per annum better off as a result.

Conclusion

A review of the National Competition Policy reveals the clear objective of promoting competition throughout the Australia economy through the economy wide application of the TPA and the removal of regulatory and structural impediments to competition. Where competition was not possible, access regimes and regulation constraining monopoly pricing were introduced to ensure that competition in related industries was not impeded. Measures of Australia's economic performance and the performance of industries that were reformed indicate that competition has delivered many of its promised benefits and was a worthy guiding principle.

⁶ Australian Rail Track Corporation (2003) *Annual Report 2002-03*.