
Recent Developments in Competition Policy

Notes for presentation to ACT Economic Society

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Presentation in three parts:

1. The outcomes of National Competition Policy (NCP)
2. A demonstration of the resources available on the Council's new NCP website – www.ncp.ncc.gov.au
3. The Council's roles in relation to third party access to monopoly infrastructure

NCP

Australia's governments agreed to the NCP programme following their consideration of the August 1993 Hilmer Committee Report into a National Competition Policy for Australia.

The NCP programme, which was agreed in April 1995 and ran until 2005, placed competition at the forefront as a means of securing productivity, economic growth and a broadly defined Australian national interest.

At the same time it recognised that competition was not always consistent with valid national interest objectives. While the NCP reforms provided for a presumption in favour of competition, this could be rebutted where it could be established that the national interest required restrictions on competition, for example where competition would not achieve efficiency or conflicts with other social objectives.

The NCP reforms were a series of commitments entered into by all Australian governments, (Australian Government and states and territories, with reform commitments also relating to local government activity). These spanned agreements to:

- the national application of the Trade Practices Act to reduce anticompetitive behaviour at all levels of the economy
- apply competitive neutrality between significant government businesses and their private sector competitors
- consider the structural reform of public monopolies before the introduction of competition (with privatisation as an option but not a requirement)
- create independent price regulation of monopolies

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- undertake a comprehensive programme of legislation review and reform to ensure all restrictions on commercial competition were justified and anticompetitive restrictions were minimised
 - introduce regulation gate-keeping measures to ensure new regulatory proposals are scrutinised to ensure any restrictions on competition are justified
 - introduce measures to ensure legislatively backed third party access to essential infrastructure services, and
 - undertake specific reforms in the energy, road transport and water sectors.

The NCP also created some unique institutional arrangements:

- First and foremost (from the NCC's perspective) it established the NCC as an independent assessor of the performance of all governments in meeting the reform commitments THEY HAD entered into.
- Second, the NCP created a regime of competition payments from the Commonwealth to state and territory governments as a means of sharing the dividends from NCP reforms. These payments were additional or new money for states and territories. They were subject to the states and territories meeting their agreed reform commitments, and could be reduced if commitments were not met.

What was achieved?

The NCC final (2005) assessment of governments' reform implementation progress found that during the period of the NCP programme (1995 to 2005) governments achieved the large majority of planned NCP reforms. For example:

- All state and territory governments had extended the Trade Practices Act prohibitions against anticompetitive behaviour such that the Competition Code now applies to all persons within a jurisdiction's reach.
- Governments had generally met commitments on structural reform, in particular recognising the need to remove regulatory functions from government businesses that operate in markets with private sector competitors.
- Governments had reviewed the bulk of the 1750 laws they had identified as restricting competition, and removed many restrictions found not to provide a community benefit. Although some jurisdictions made insufficient progress, in aggregate terms, governments reviewed and, where appropriate, reformed around 85 per cent of their nominated legislation.
- All governments had gatekeeping mechanisms to assess new legislation that could, in principle, operate to ensure compliance with their NCP commitments. While governments improved their approach to gatekeeping over the period of the NCP, most arrangements fell short of best practice. Governments, through effective gatekeeping, need to rationally assess the costs and benefits of regulation as a safeguard against the introduction of legislation that is not in the public interest.

Much more detail is available in the NCC’s assessment reports.

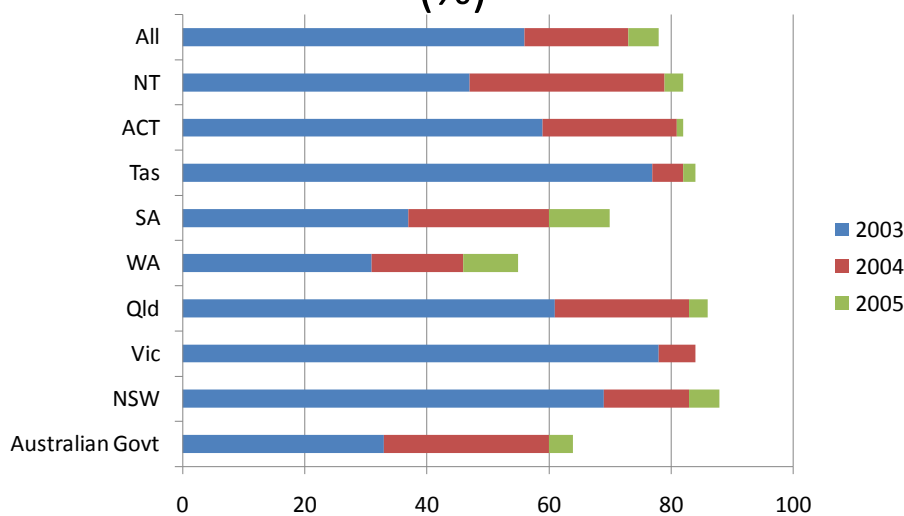
Chart 1 shows that while the outcome overall was substantially positive, the results on a jurisdictional and sectoral basis were somewhat mixed. This is perhaps unsurprising given the scope of the NCP reforms.

Chart 1: Summary of NCP Outcomes

	Energy Reform	Road Reform	Competitive Neutrality	Structural Reform	Legislation Review	Gate-keeping (out of 5)
Australian Govt	✓	✗	✓	✗	✗	✓✓✓✓
NSW	✓	✓	✓	✓	✓	✓
Vic	✓	✓	✓	✓	✓	✓✓✓
Qld	✓	✓	✓	✓	✓	✓✓
WA	✓	✗	✗	✓	✗	✓
SA	✓	✓	✓	✓	✗	✓✓
Tas	✓	✓	✓	✓	✓	✓✓
ACT	✓	✗	✓	✓	✓	✓
NT	✓	✓	✓	✓	✓	✓✓

Also there was variability in implementing the legislation review and reform programme, as shown by **chart 2**, which summarises jurisdictions’ progress over time in reviewing and reforming priority I

Chart 2: Priority legislation reviewed (%)



egislation.

The Productivity Commission (PC) in its 2005 review of the NCP reforms found that:

NCP has delivered substantial benefits to the Australian Community which, overall, have greatly outweighed the costs.

The PC noted in particular that the NCP had:

- contributed to the productivity surge underpinning (at 2005) Australia's 13 years of uninterrupted economic growth (Australia's productivity growth in the late 1990s was very strong by international standards, and achieved despite a decade of economic stagnation in Japan and the 1997 Asian financial crisis)
- contributed to an increase in real per capita incomes (the rate of increase in the second half of the 1990s was as high as at any time in the 20th century)
- contributed to reducing unemployment (at 2005 the rate of unemployment was at its lowest level in three decades while labour force participation was at its highest level since WW1)
- directly reduced the prices of goods and services
- stimulated business innovation, customer responsiveness and choice
- helped to meet some environmental goals including the more efficient use of water.

The PC used quantitative analysis on three occasions to illustrate the economy wide impacts of the NCP reforms.

- In 1995 the PC modelled many of the Hilmer recommendations finding that at the 'outer envelope' Australia's level of real GDP would be 5.5 per cent higher once the changes associated with the reforms had worked their way through the economy.
- In 1999 the PC undertook a similar exercise for a sub-set of reforms relevant to rural and regional Australia that projected a boost to GDP in the longer term of 2.5 per cent.
- In its 2005 review of the NCP reforms, the PC quantified the economy wide gains from productivity improvements and price changes in key infrastructure areas observed over the 1990s. It found that these had boosted Australia's GDP by 2.5 per cent or \$20 billion. This modelling did not pick up the effects of dynamic efficiency gains from more competitive markets so is a conservative estimate.

Critical elements in the success of the NCP

The NCP succeeded because it incorporated general programmes and sector-specific reforms, and was based on sound public policy principles and effective governance arrangements, within an agreed all-embracing reform programme which also provided incentives for reform implementation.

Jurisdictions were able to implement reforms according to their own priorities within agreed overall targets and timeframes that they themselves had developed. This provided flexibility, while at the same time imposing discipline and accountability.

Informed transparent reporting itself provided an incentive to meet objectives. Direct incentives, in this case the NCP payments to the states and territories where independent assessment showed that reform objectives were delivered, provided additional encouragement.

Governance arrangements provided for informed independent monitoring of outcomes and transparent reporting on outcomes, including where commitments were not being delivered.

An independent body, with appropriate authority and clear lines of accountability, was important. It is difficult for parties that are responsible for developing and implementing reform programmes to also credibly undertake the progress assessment and reporting task.

The NCC is a creature of all Governments not just the Commonwealth: the NCP programme would not have worked as well had the states and territories not seen the NCC as independent from the Commonwealth.

Finally, the NCP succeeded because it was instrumental in creating what the Organisation for Economic Cooperation and Development (OECD) called a deep-seated 'competition culture' among policy makers and assisted as far as possible the development of greater community understanding of the benefits from a more competitive economy.

What could have been done better under the NCP?

Many reform objectives under the NCP programme were substantially met. All governments have appropriate price oversight mechanisms in place and generally have removed regulatory functions from public monopolies operating in competitive markets. Each government has also applied competitive neutrality principles to their large government businesses and has some form of complaints mechanism in place. Commitments relating to third party access to the services provided by essential infrastructure facilities have been implemented.

The key areas of unfinished NCP business were perhaps the completion of the legislation review and reform programme and improving regulation gatekeeping arrangements, and water reform. Improving the application of competitive neutrality principles and better adherence to structural reform principles also warrant attention.

As shown in Chart 2 - Governments did not meet the timeframe set by COAG for completing their legislation review and reform agenda. While they delivered substantial elements of the programme, and the reform dividend to the nation is evident, some legislative reforms did not progress as fully as might have been envisaged.

Ensuring the quality of new legislation (gatekeeping) is fundamental to Australia's prosperity. Effective gatekeeping is a key to moving towards regulation that achieves its objectives without unwarranted efficiency and compliance costs.

Energy reform will continue to require attention.

The road transport reform obligations were substantially met but were fairly limited, suggesting further integrated and coordinated reform of land transport (and coastal shipping and ports) is needed. COAG agreed (February 2006) to a range of reforms aimed at improving the efficiency, adequacy and safety of Australia's transport infrastructure.

Key elements of the NCP water reform programme remained outstanding at the end of the NCP. COAG endorsed a forward reform programme for water beyond the 1994 water reform framework that had been incorporated in the NCP.

Following on from the NCP: the COAG Reform Agenda

Economic reform task is somewhat like walking up a down escalator — in a globally competitive environment, reform inertia will inevitably mean declining living standards. Best practice today may tomorrow be an impediment to the nation achieving its growth potential.

COAG had agreed in November 2000 that it would review the NCP reform agenda and arrangements before the end of the programme in 2005. Accordingly, in 2004, the Australian Government requested the PC to inquire into the impacts of the NCP and report on future areas 'offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition'.

Critically, the PC noting that population ageing and other challenges will constrain Australia's capacity to improve living standards into the future, strongly advocated further broad reform to achieve a more productive and sustainable Australia. I outlined the key findings of the PC's review of NCP reforms concerning the benefits from the NCP earlier.

Drawing from the PC review and other sources, COAG agreed to a new economic reform agenda now referred to as the COAG Reform Agenda (CRA) and supporting institutional arrangements.

The CRA agreed on 26 March 2008 has the objective of boosting productivity, workforce participation and geographic mobility, and supporting wider objectives of better services for the community, social inclusion, reducing Indigenous disadvantage, and environmental sustainability.

On business regulation, the COAG agenda encompasses 27 areas of regulatory reform aimed at enhancing productivity and workforce mobility by cutting the costs of regulation.

On the broader productivity agenda, COAG embraced long-term reforms across education – covering early childhood development, schooling and vocational education and training.

The Memorandum of Understanding on Murray-Darling Basin Reform is aimed at enabling action to address over allocation, improve environmental outcomes, and enhance the efficiency of irrigation.

COAG re-affirmed its commitment to microeconomic and regulatory reform, recognising that better regulation enhances Australia's productivity and international competitiveness, deepening the supply potential of the economy, driving its ability to adapt faster and raising the potential growth rate. In this regard, it has recognised the considerable scope for further microeconomic reform in a number of priority areas to reduce the costs of regulation and enhance productivity and workforce mobility (National Partnership Agreement on a Seamless National Economy).

Importantly, COAG is aiming at continued progress on regulatory reform and related processes with the objective of all jurisdictions improving the efficiency of their regulation.

The architecture for Commonwealth-State funding arrangements has been reformed to enable the states and territories to deploy Commonwealth specific purpose payments (SPPs) more effectively and to sharpen the incentives for reform through new National Partnerships (NP) agreements.

The SPPs are the main means through which the Commonwealth delivers funding to the states and territories to meet their service delivery obligations. The NPs provide funding for specific projects in areas of joint Commonwealth/state responsibility such as transport, regulation, environment, water and early childhood and reward states and territories that deliver on reform. The NPs provide a framework through which the Commonwealth and a state or territory can agree on a reform and pursue it, separately from the main Specific Purpose Payments funding framework.

COAG established the COAG Reform Council (CRC) to support the implementation of the CRA. The CRC's role is to:

- monitor and report on important reforms agreed by COAG aimed at increasing the nation's productivity and workforce participation
- report on performance information against the SPP outcomes and progress measures
- assess whether predetermined milestones and performance benchmarks have been achieved under NP agreements and
- assess the performance of the Commonwealth and Basin States under Commonwealth-State Water Management Partnerships as part of the *Agreement on Murray-Darling Basin Reform*.

The CRC reports directly to COAG. At the request of COAG, the CRC also reports to the Prime Minister as the Chair of COAG in regard to its monitoring and assessment role within the new Commonwealth-State Financial Framework. Like the NCC under the NCP, the COAG Reform Council does not set reform agendas, provide policy advice or implement reforms.

Third Party access to monopoly infrastructure

Now that responsibility for microeconomic reform has moved the CRC and CoAG I'd like to take the last part of my time to discuss the NCC's ongoing responsibilities in relation to third party access to infrastructure.

As some of you will know the move to refocus the NCC's activities in this area has not seen our escape from controversy. In particular efforts by Fortescue Metals to gain access to Pilbara railways owned and operated by BHP and Rio Tinto have met strong resistance.

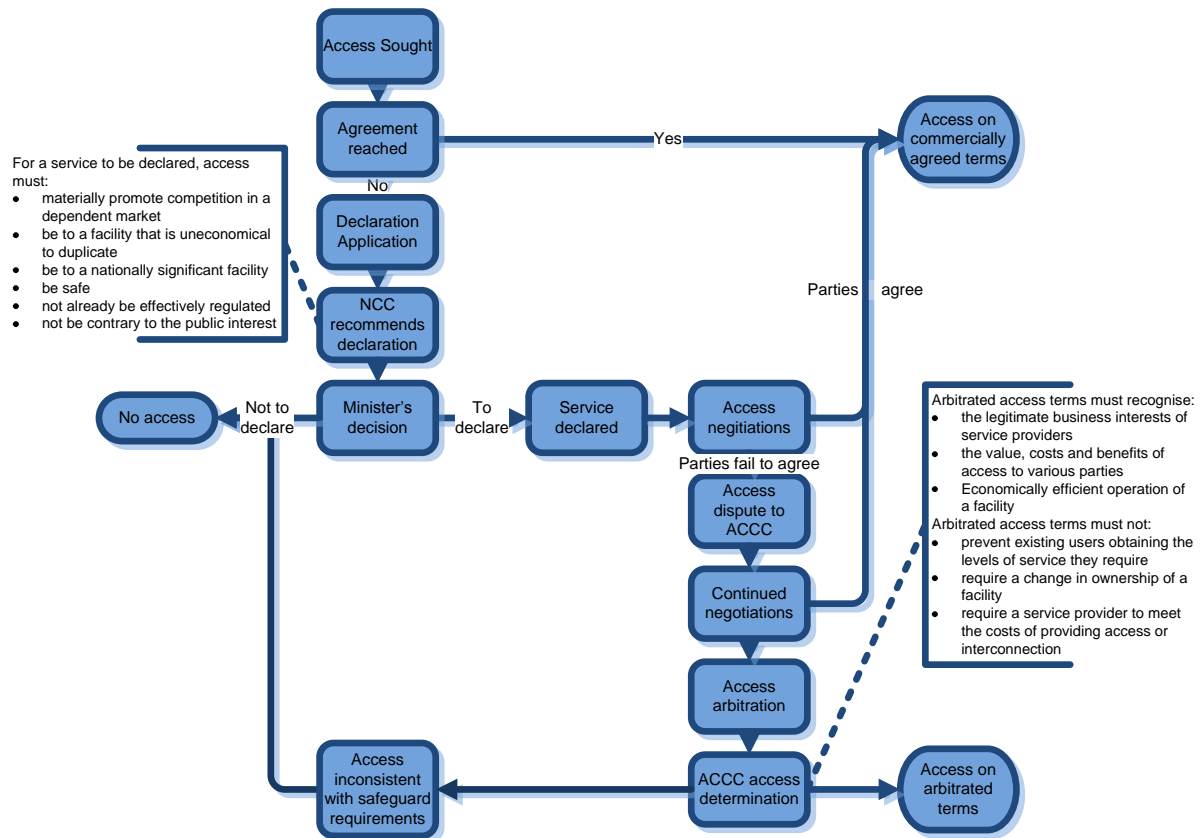
The purpose of the National Third Party Access Regime is to provide a mechanism for resolution of disputes over access to infrastructure services where it is in Australia's national interest that such disputes are resolved.

The National Access Regime is established in Part IIIA of the Trade Practices Act 1974. Part IIIA also provides for access undertakings to be submitted to and approved by the ACCC and for state and territories to develop access regimes. In some circumstances these may supplant the National Access Regime as the means of providing for regulated access to particular infrastructure services.

In most cases access to infrastructure services is arranged through private commercial negotiation. But, in a limited set of circumstances, regulatory intervention is desirable and necessary to ensure appropriate access is available. The National Access Regime allows for regulatory intervention in access disputes where it is in Australia's national interest.

Regulation under the National Access Regime involves a two stage process, a **declaration stage**—which determines whether the criteria for applying access regulation are met and if so allows a service to be declared—and a **negotiate/arbitrate stage**—where a service provider and access seekers enter into negotiations and where the Australian Competition and Consumer Commission (ACCC) can be called on to arbitrate access disputes the commercial parties cannot resolve for themselves.

This Chart endeavours to summarise the process for third party access and the critical considerations that apply.



Declaration stage

An access seeker may apply to the National Competition Council (NCC) to have an infrastructure service 'declared'. The NCC conducts a public consultation process and then makes a recommendation to a designated Minister (usually the Assistant Treasurer/Minister for Competition Policy – Chris Bowen) who makes the final decision whether or not to declare a service.

The NCC may only recommend declaration (and the Minister may only decide to declare a service) where six declaration criteria (a-f) are all satisfied.

The **declaration criteria** are:

- a) that access (or increased access) to the service would promote a material increase in competition in a dependent market

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- access to the service must be critical to the development of competition in the dependent market.
- b) that it would be uneconomical for anyone to develop another facility to provide the service
- the facility that provides the service must exhibit natural monopoly characteristics (significant economies of scale or scope, large size relative to the markets it serves, high capital costs and relatively low variable operating costs, etc.) such that one facility can provide all the required service at least cost and establishing additional facilities would waste resources and increase costs to the economy as a whole.
- c) that the facility is of national significance
- the facility must be important in terms of its size, contribution to trade and commerce and the national economy.
- d) that access can be provided without undue risk to human health and safety
- e) that the service is not already the subject of an effective access regime
- f) that access (or increased access) is not contrary to the public interest
- this allows the NCC and the Minister to refuse declaration where access would be contrary to Australia's public interest. Under this criterion access could be refused where, for example, it could be shown that access would result in unacceptable environmental degradation.

Under the National Access Regime the NCC has four months to make its declaration recommendation. The designated Minister then has 60 days to make a decision. If the Minister fails to make a decision within the 60 day decision period, the application for declaration is deemed to be declined.

A party that is dissatisfied with the Minister's decision may seek reconsideration of the decision by the Australian Competition Tribunal. Such applications must be made within 21 days.

A decision to declare a service comes into effect after 21 days unless an application for reconsideration has been lodged in which case the declaration is stayed until the Tribunal makes its decision.

Once a service is declared a service provider is required to enter into access negotiations with access seekers. This requirement is not limited to the party that made a declaration application, other access seekers can also seek to use the declared service.

Negotiate/arbitrate stage

The negotiate/arbitrate process that results from the declaration of a service is intended to maximise opportunities for commercial resolution of access issues, minimise regulatory intervention and protect the legitimate interests of service providers so as to ensure that incentives for efficient investment are maintained.

If access negotiations in relation to a declared service reach an impasse, an access dispute may be notified to the ACCC which will then conduct an arbitration process. As arbitrator the ACCC has broad scope to make orders to resolve an access dispute—although it must do so within the terms set out in the National Access Regime. In particular, the ACCC is bound by a series of safeguard provisions that ensure the interests of access seekers and service providers are balanced with the national interest.

The safeguard provisions include that in arbitrating an access dispute:

- the ACCC is required to take into account:
 - the objects of the National Access Regime (which include the efficient use of and investment in infrastructure and promoting effective competition in dependent markets);
 - the legitimate business interests of the provider, and the provider's investment in the facility;
 - the public interest, including the public interest in having competition in markets;
 - the interests of all persons who have rights to use the service;
 - the direct costs of providing access to the service;
 - the value to the provider of extensions (to a facility) whose cost is borne by someone else;
 - the value to the provider of interconnections to the facility whose cost is borne by someone else;
 - the operational and technical requirements necessary for the safe and reliable operation of the facility;
 - the economically efficient operation of the facility.
- the ACCC is required to apply pricing principles which provide that access prices should:
 - be set so as to generate expected revenue that is at least sufficient to meet the efficient costs of providing access
 - include a return on investment commensurate with the regulatory and commercial risks involved
 - allow for multi part pricing and price discrimination when this aids efficiency, but not where a vertically integrated access provider seeks to favour its own operations
 - provide incentives to reduce costs and improve productivity.

Furthermore, the ACCC is specifically prohibited from making an access determination that would prevent an existing user having sufficient capacity to meet its reasonably anticipated requirements, and no determination can result in a transfer of ownership of any part of a facility. Where expansion

or enhancement of a facility is needed to accommodate access seekers, a service provider can be required to undertake such expansion, but the costs of this are to be met by the access seekers along with interconnection costs.

Ultimately if the ACCC is unable to arrive at access terms that appropriately recognise the interests of an infrastructure owner, then it does not have to require the provision of access to a declared service. ACCC arbitration determinations are subject to merits review by the Competition Tribunal.

Application of the National Access Regime

Since it was implemented in 1995 30 applications for declaration have been considered under the National Access Regime. Of these, 14 applications were withdrawn, five applications were unsuccessful and seven applications were successful resulting in declaration of 12 services.¹ As at 31 March 2009 decisions on four applications were under review by the Competition Tribunal.

In the same time period two access disputes have been notified by to the ACCC (both in 2007). The ACCC was required to make an arbitration determination on one of these disputes; the other was settled by the parties before the arbitration was concluded.

Is the regime meeting its objectives?

The small number of access declarations and even smaller number of arbitrations is no surprise—it was never intended that the regime would be widely applicable.

There has been strong criticism of the Regime from some quarters—but in the Council’s view this largely reflects the commercial interests of particular parties which differ from the national interests of Australia which are far better served by enhanced competition and sharing of valuable infrastructure on appropriate terms and subject to the stringent conditions applicable in the National Access Regime.

Some of the criticism is simply based on a misunderstanding of the consequences of declaration. Declaration of a service does not lead to an asset owner losing control, let alone ownership, of their asset, nor does it require that third party access be subsidised.

The ACCC is not required to allow for access to occur where this will excessively disrupt existing use of infrastructure.

In the Council’s view the safeguards within the National Access Regime properly balance the national interest while recognising the rights of asset owners and there is no evidence to the contrary.

The criticism of the National Access Regime that is justified is that the time taken to resolve access issues is too long and perhaps more importantly unpredictable. This results in an unacceptable level of risk and uncertainty for all parties.

¹ Of these, four have expired. As at 31 March 2009 eight services were subject to declaration— six were for sewage transport services and sewer connection services provided via three Sydney area sewerage reticulation networks; one related to airside services at Sydney Airport and one was for the services provided by the Tasmanian railway network.

In recent weeks the Assistant Treasurer has announced a series of proposals to reform the processes within the National Access Regime to enhance certainty and assist the Council and other bodies deliver decisions within commercially realistic timeframes.

Following consultation with the states and territories, legislation to amend the National Access Regime is expected to be introduced into Parliament in mid-2009. The reforms in summary will:

- implement COAG Competition and Infrastructure Reform Agreement commitments to introduce binding time limits and limited merits review
- streamline Part IIIA decision-making criteria and processes, and improve regulatory certainty and
- reform ACCC and NCC administrative processes, and Australian Competition Tribunal review processes, to improve the timeliness of outcomes.

We look forward to these streamlining reforms helping to improve the operation of Part IIIA including that effective third party access outcomes are achieved in more commercially relevant timeframes.

The Council strongly supports these changes and urges their swift implementation.