



NATIONAL
FARMERS'
FEDERATION
AUSTRALIA

National Farmers' Federation

Productivity Commission Inquiry

**The Impact of Competition Policy
Reforms on Rural and Regional
Australia**

November 1998

Prepared by Todd Ritchie
Director, Economic Policy

NFF House
14-16 Brisbane Avenue
BARTON ACT 2600
PO Box E10
Kingston ACT 2604
AUSTRALIA
Tel 61 2 6273 3855
Fax 61 2 6273 2331

Contents

1. Executive Summary
2. Introduction
3. Trade Practices Act and Statutory Marketing Authorities
4. Reform of Government Monopolies
5. Infrastructure Reform
6. Competitive Neutrality
7. Impact on Rural Services
8. Public Interest Test
9. Community Service Obligations
10. Conclusion

1 Executive Summary

The National Competition Policy (NCP) program introduced by the nine State, Territory and Commonwealth Governments was aimed at lowering business costs, enhancing competitiveness and creating incentives in order to facilitate sustainable economic growth. In other words, NCP is concerned with deriving improved performances from the economy which would allow the economy to sustain faster growth without encountering inflation or balance of payments problems.

Australian agricultural producers are generally among the most productive and efficient in the world as a result of long exposure to world markets, and a preparedness to move in and out of, markets in response to demand. These factors stand Australian agriculture apart from many others in the international market place who require their governments to protect or subsidise their agricultural products.

After three years of the application of competition policy, a range of concerns are being expressed in rural and regional Australia. These include fears of a reduction in or increased cost of services, changes to co-operative marketing arrangements, reduced income from export markets, increased farm input costs, (with particular emphasis on water), and an uneven distribution of the benefits and costs with the costs being borne by regional Australia and the benefits accruing to metropolitan areas and big business.

Rural and regional Australia increasingly sees itself singled out for disruptive reform processes while other parts of the economy that are also uncompetitive remain untouched. In addition the timing of NCP reforms, corresponding as they do with a period of low commodity prices and economic disruption in Australia's major export markets has also created tensions.

While the over-arching aim of NCP must be to contribute to achieving the most efficient use of resources, governments must play a role in facilitating adjustments to change in those areas where change brings significant dislocation and short term costs. In addition, NCP along with other microeconomic reforms must apply equally to all sectors of the economy. This is an important consideration for Australia's rural producers who face both inefficient post farm gate processes and significant concentration of market power in the agricultural marketing chain.

Review of agricultural marketing laws is an area of competition policy that is of great relevance to the rural sector. Agricultural marketing arrangements must be assessed individually, giving attention to the special features of the product and its market, in order to create greater economic wealth.

The single seller status permits Australian producers to be the single large effective marketer in the export market, which ensures the maintenance of production efficiencies in our industries. Australia benefits if the Statutory Marketing Authority (SMAs) can either gain a greater share of the market and/or a better price as this brings in additional export income.

SMAs can also play important roles in areas such as standards and quality control fostering appropriate research and development linkages.

Many Government domestic service monopolies are currently being reformed. However, for rural and regional Australia, the reform of Australia Post and Telstra are of most importance.

The services provided by Australia Post remain vital to people living in rural and regional Australia. Despite the improvements in electronic telecommunications these new forms of communications are not yet fully available in rural and regional Australia and do not replace the need for a postal service that allows the interchange of physical items, such as the supply of health and educational material to people in remote areas.

Investment in regional telecommunications infrastructure, is also critical to rural and regional communities. For these communities, affordable access to the latest information technology is an important aspect of reducing the tyranny of distance.

Implementation of the NCP program necessarily involves difficult judgements about public costs and benefits. Therefore the public interest test should be applied in a long-term time frame thereby allowing all of the implications of change to be fully considered and issues of sustainability to be considered.

In many instances, change involves a short term cost or disadvantage as a trade-off for perceived future benefits. If the total of the future benefits exceeds the adjustment or short-term costs, then it may be in the public interest for the change to proceed. However, if change proceeds assistance or support should be considered for those who suffer the short-term costs.

The notion of Community Service Obligations (CSOs) is also closely related to NCP. CSOs arise in a range of areas, including access to health services, provision of water, sewerage and electricity, telecommunication services, quarantine services, education, banking, public transport and mail services. The delivery and funding of CSOs should be assessed on a case-by-case basis.

Review of regulations governing competition demands more than indiscriminate dismantling of regulation. Developing more competitive markets requires careful design of regulatory systems that acknowledge the nature of the products, the participants and the markets in question, so as to produce outcomes that are efficient and maximise economic benefits. It should be noted that some of the

most efficient and competitive markets (for example, equities) are, in fact, heavily regulated to protect the interests of participants.

It is also important also that reform extends to all areas of anti-competitive regulation in order to generate the full measure of benefits to the economy. Should reform address only some areas of competitive failure and not others, then only some industries will benefit and these may not necessarily be those in which Australia has a comparative advantage. The implicit bias created by partial reform would move Australia from one distorted economic structure to another distorted structure with little real gain in economic welfare. Indeed, the reforms more commonly focussed on, including public utility services, the professions and government business enterprises, will not yield their full improvements in efficiency if restrictions remain on inputs, such as labour.

The role of NCP is increasingly viewed as poorly defined, with benefits that are not always tangible and review process that are lacking in transparency. Therefore it is critical that there is adequate public education and consultation about the reforms, and their progress. Such public education arrangements should have been put in place earlier, by all agencies involved in implementing the reforms.

2 Introduction

This submission will broadly follow the framework indicated in the Productivity Commission Issues paper. The main areas covered in this were:

- The implications for rural industries arising from the broadened application of the Trade Practices Act, and from reviews of legislation affecting statutory marketing authorities and co-operatives;
- The impact of NCP-related infrastructure reforms;
- The effects on service delivery in country Australia of reform of government monopolies;
- The implications for local government activities from the application of competitive neutrality;
- The distribution of the benefits and costs from NCP between country and metropolitan Australia; and
- measures to facilitate the flow of benefits (or reduce the costs) to country Australia.

The submission will also cover the Public Interest Test (PIT) and Community Service Obligations (CSOs). It should also be noted that a number of NFF affiliated State and Commodity organisations will be providing more detailed submissions on the impact of NCP on their respective States and commodities.

Given the complexity of the issues to be covered in this inquiry and the short time frame available for response it would be beneficial if the Commission gave consideration to a draft report for comment before delivering its findings.

The NCP program introduced by the nine State, Territory and Commonwealth Governments was aimed at lowering business costs, enhancing competitiveness and facilitating sustainable economic growth.

In other words, NCP is concerned with deriving improved performances from the economy. This will allow the economy to sustain faster growth without encountering inflation or balance of payments problems.

An initial assessment of the reforms puts the benefits to the economy at 5.5% of GDP with a resultant increase in real wages of 3.0 per cent and employment gains of 30,000.

A more recent exposition of some of these gains was provided by Graeme Samuel of the National Competition Council. Samuel pointed to price reductions as a result of competition including more than 20% for grain haulage by rail in Western Australia; 25%-30% for electricity in some states; 40% for

container rail freight; and up to 50% for gas. He also pointed to falls in average charges by government-run business, and increased payments to government.

However acceptance of these gains has not been universal and after three years of the application of competition policy, a range of concerns are being expressed in rural and regional Australia. These include fears of a reduction in or increased cost of services, changes to co-operative marketing arrangements increased farm inputs costs, (with particular emphasis on water), and an uneven distribution of the benefits to metropolitan areas or big business.

These fears have been exacerbated by the generalised weakness of commodity markets and more recently by the uncertainties associated with Asia. Indeed there may be a case for delaying or slowing the process of NCP reforms until commodity prices improve and those Asian economies stabilise.

Agriculture represents the very beginning of the production chain for a large number of commodities. Without an efficient and competitive agricultural sector at the base of the production pyramid, many manufacturing industries would not exist. In the case of many exported goods it is the efficiency of the production process up to the farm gate that makes the eventually transformed product competitive on the world market.

The aim of competition policy as it applies to agriculture should be to facilitate efficient and market oriented rural and related industries, focussed on export opportunities. The maintenance of a viable commercial sector in regional areas must therefore be an important aspect of NCP. Agriculture and the other business sectors it supports in regional Australia will face a diminished international competitiveness if there is a decline in efficiency in rural areas.

In many cases this will involve the fulfilment of CSOs that arise in a range of areas, including access to health services, provision of water, sewerage and electricity, telecommunication services, education, public transport and mail services.

While the over-arching aim of NCP must be to contribute to achieving the most efficient use of resources, governments must play a role in facilitating adjustments to change in those areas where change brings significant dislocation and short term costs. In addition, NCP must apply equally to all sectors of the industry.

Generally, freely functioning markets domestically and internationally will provide price signals that reflect consumer preferences and thereby allow the value of any input to be derived from the value it adds to the production process. However, markets can sometimes fail to meet these objectives. Most examples of market failure involve the existence of public goods (where consumption of the good cannot be excluded), the existence of externalities, or a tendency to concentrated market power as a result of large or unlimited economies of scale.

Clearly in these areas there is a need for government involvement to correct these market inadequacies.

In this context, agricultural marketing arrangements must be assessed individually, giving attention to the special features of the product and its market, and criteria must be developed to ensure rigorous consideration of potential social and economic impacts, particularly on rural communities, during policy development.

3 The Trade Practices Act and Statutory Marketing Authorities

Australian agricultural producers are generally among the most productive in the world as a result of exposure to and a preparedness to move in and out of, markets in response to demand. These factors stand Australian agriculture apart from many others in the international market place who require their governments to protect or subsidise their agricultural products.

However, production efficiency alone may not be sufficient to ensure an acceptable level of financial return to the agricultural producer. Agriculture needs to be proactive in establishing the requirements of our present and future markets. Marketing practices should therefore be aimed at maximising market share for that product at a price level which will ensure long-term continuity of economic production.

Review of agricultural marketing laws is an area of competition policy of great relevance to the rural sector.

Historically, SMAs were set-up to protect the large number of small farmers in the market from the more powerful merchants. They gave the farmer a legislatively established vehicle through which they could influence the prices they were obtaining for their produce and allowed them to provide some direction to the development of their industry.

The subject of marketing of agricultural products is complex, as it involves other industries where the producers influence is limited, and where generally micro-economic reform is also required.

In such a diverse industry as agriculture a single solution is not possible and the needs of the different commodity groups will be met by various levels of regulation.

The TPA makes explicit provision for voluntary arrangements, and a large number of voluntary export co-operatives already exist. In addition the NCC has indicated that compulsory marketing arrangements will be retained if it can be demonstrated that they provide an overall community benefit and are the only feasible way to obtain that benefit.

For example, the NSW rice and Queensland sugar reviews resulted in the retention of export monopolies for both those industries.

There are a range of benefits associated with SMAs and these are discussed below. Critics of current agricultural marketing arrangements argue that SMAs

represent an unwarranted Government intrusion in the marketplace and restrict competition. For this argument to have validity the removal of all market intervention must lead to a market which more closely resembles a perfectly competitive environment than existed under an SMA.

These critics pointed to a number of potential benefits from reform. These include:

- A greater freedom to choose how, when, at what price and to whom products are sold;
- A possible reduction of the share of farmers' returns spent on administration costs;
- Greater individual control over production, marketing and risk-management decisions;
- Greater incentives and opportunities for farmers, producers and rural communities to undertake innovative marketing and invest in higher-value, post-farm products; and
- Removal of inappropriate (assumes incorrect now) price signals as a result of the appearance of financial viability.

In general, a free and competitive market environment will be the most efficient allocator of resources if the conditions of perfect competition are present domestically and internationally. These conditions include:

- A sufficiently large number of buyers and sellers to enforce competitive behaviour;
- Freely available information to allow informed choice among participants;
- Homogeneity of product;
- The ability to instantaneously adjust to changing market conditions;
- No fixed capital requirements;
- Perfect rationality among participants;
- Zero or very low transaction costs; and
- No barriers to entry.

These conditions are rarely, if ever met. Markets can exhibit artificial barriers, lack of information and a sufficient number of participants on only one side of the market and consistently fall short of producing the perfect outcome of full economic efficiency.

The increasing concentration of ownership in the agribusiness industry and supermarket chains clearly illustrates that within the domestic market there is frequently a large number of participants on only one side of the market, thus violating one of the conditions for perfect competition.

The collective purchasing and marketing power of these businesses gives them an oligopolistic bargaining position, enabling them to capture a greater share of

the revenue from a product by squeezing the incomes of other participants in the supply chain. In the case of agribusiness, the squeeze can also be applied on the costs side as well. Agribusiness can potentially restrict farmers' access to markets and distort market forces if one firm controls inputs such as chemicals, fertilisers, insurance, credit and breeding stock, as well as downstream activities such as transport, distribution, processing and marketing.

This situation is exacerbated because the natural bargaining power is particularly low for agricultural producers who face long lead times, uncertain output and perishable products.

In this case the Government can, through regulation, encourage the development and maintenance of more competitive markets, thereby producing an outcome which more closely resembles that of a perfectly competitive market.

NFF has encouraged the integration of specialist processing and marketing of farm products more closely with on-farm production. A closely integrated production and marketing structure is more likely to respond quickly and efficiently to market demand. This integration can only be achieved if there is a harmonisation of industry policy and NCP. This would add to Australia's valuable competitive advantage and help transform agriculture and agricultural marketing authorities. Strategically, Australia must build on and develop existing agricultural marketing organisations, not simply dismantle the present structures in a hope that something more efficient will grow in their place.

SMAs can play important roles in areas such as standards and quality control, fostering appropriate research and development and international sales. These are discussed below.

Standards and Quality Control

Statutory marketing authorities set and enforce standards. In markets characterised by many small producers, where individual brand name development is difficult to achieve and quality is not readily assessable, standards are an important development that allows buyer preference to be transmitted through the market.

Misdescription of products by one individual can impose large externality costs on other producers by discrediting the standards and damaging the reputation of the Australian product, especially on export markets. Uniform administration of standards can avoid these external costs while ensuring that the benefits of enhanced transmission of market signals are preserved. While in some cases standards can be administered without statutory powers, it will generally be more efficient and less costly to use legislation to achieve compliance.

It is of course reasonable to ask whether such standards stifle innovation or diversity in the market. However, in most cases are less than optimal level of

innovation may be symptomatic of inappropriate standards, and not the existence of the standard in itself. Where standards are inhibiting trade, the appropriate response is to redefine standards to ensure adequate coverage of the quality differentials in production.

Research, Development and Promotion Levies

Statutory marketing activity can involve the sanctioning of compulsory levies and their administration in areas such as R&D and promotion and market development. The rationale for compulsory participation stems from the presence of many small farmers producing a largely homogeneous product. Collectively the product may possess features which will make it profitable to undertake promotion and expenditure on market development.

“Free rider” problems are a serious impediment to voluntary schemes aimed at funding expenditure on market development, and in many cases, research and development. Individuals will always be better off if they do not contribute to this expenditure while reaping the benefits of expenditure by others. While there are examples of small scale voluntary promotion schemes, for example King Island beef, these rely heavily on peer group pressure, and would be subject to break-down at a larger scale.

Compulsory levy collection for purposes such as R&D and promotion may be the only feasible way to eliminate free rider problems in many products, while continuing to generate the benefits, which are available from expenditure, in these areas. Concerns frequently emerge about the level and the direction of the expenditure of levy funds. These concerns relate more to the mechanisms and structures through which expenditure is administered, and not the fundamental compulsory nature of the levies. Indeed, voluntary or private research and market development programs can face many of the same difficulties over the level and direction of expenditure.

Single Desk Export Powers

Single, national export seller status has been created by statute for some agricultural commodities and is a very visible case of compulsory participation. Single export status is most commonly used to capture price premiums which are available to a monopoly seller in international markets. However, often there are also market development and standards issues, as outlined above, which are relevant to the export marketing effort, and from which benefits can be extracted by a statutory export authority.

The single seller status permits Australian producers to be a single large effective marketer in the export market, which ensures the maintenance of production efficiencies in our industries and forces reform in the intermediate agencies of product handling, storage, marketing and distribution. Australia

benefits if the SMA can gain a greater share of the market and a greater return, as this brings in foreign income.

While it is difficult to generalise all the circumstances which lead to benefits from single export arrangements, some key features can be identified – the Australian product must be able to be differentiated from the products of competing supplier countries. Although this provides the opportunity for monopoly gains in many products, there are other cost factors which may overshadow these benefits.

For example, where there is a high degree of local variation in the quality of output, for instance meat, there are inefficiencies in highly concentrated selling which arise from the difficulty in ensuring consistent quality in the delivered product. Conversely, if the international buying is heavily dispersed, there may be inefficiencies of a single seller servicing many small buyers may outweigh the monopoly gains.

A market structure which does not provide open disclosure of price and quality premiums, such as private treaty on contract sales, will also favour centralised selling because of the efficiencies in establishing and negotiating prices.

Determining whether the monopoly gains and the returns from R&D or market development are exceeded by costs of centralised selling requires a close examination of each case on its merits and cannot be inferred from broad principles or examples.

Price and Production Controls.

The other principal type of compulsory intervention through statutory arrangements is price or production control. Such powers are found to varying degrees in agriculture. Examining the validity of the objectives in these instances would require a detailed examination of the structure of the market and the nature of the product to identify the failure of competitive forces and the effects of intervention.

In most cases this involves a balancing of market power in the domestic market under circumstances where producers enter the market in an extremely weak negotiating position. Factors such as the size and number of producers, their stability in the industry and the stability of output affect the prices paid by consumers, the returns to industry and the distribution of those returns among the various parts of the industry. The capacity of one or a few powerful participants to dictate terms and play smaller competitors off against each other because of perishability or produce or a similar negotiating weakness, can only be countered by ensuring all participants receive equal treatment. By definition the counterbalancing of market power cannot be achieved through voluntary measures, since any non-participants can destabilise the position of the remainder.

These instances of compulsory participation in statutory marketing are not inherently bad or contrary to the public interest. In the absence of the statutory arrangements the market is not one that would be freely or perfectly competitive. The intervention is, therefore, the result of a difficult judgement on the balance between the relative costs and benefits of a free but non-competitive market structure, and a regulated non-competitive market structure. In this context it must be pointed out that not all regulation stifles competition in a market. Regulation can promote effective competition in a market.

Reasons for and Functions of Orderly Marketing

In general, commodity markets are characterised by inelastic demand. There are few substitutes and therefore demand does not retract significantly in response to a price rise. The extent of this potential market power will vary between commodities depending on the degree to which each can influence prices.

In an overall sense, if the commodity exists in a market which it dominates or is one of the major players, there may be an advantage to be gained by Australia (and the producer) if a single seller status is used to create a market imbalance in our favour.

It is difficult to advance an argument in support of agriculture having a legislated capacity to raise prices faced by other Australians if there are no offsetting benefits. Deregulating the industry and removing special producer marketing advantages is seen as a means of reducing prices for Australian consumers whether they be wholesales, retailers or the end consumers. The inference is that the cost of deregulation will be shouldered by the producer. The result would be a removal of transfers between consumers in Australia and producers, which has little, if any, justification.

In the light of increased consumer costs, the argument for the retention of regulation in an industry can be sustained if there are advantages for the Australian economy and the consumer which greatly outweigh the additional costs of regulation.

Some possible areas of advantage to be considered are:

- A regular flow of quality product to the consumer;
- Strategic benefits in a strong local production base;
- Industry which will remain competitive because
 - its export surplus faces world competition
 - imports from countries with low labour costs;
- Intermediate industries will be forced to become efficient; and
- Industry large enough to export and gain foreign income.

4 Reform of Government Monopolies

Many Government monopolies are currently being reformed. However, for rural and regional Australia, the reform of Australia Post and Telstra are of most importance.

Australia Post

The services provided by Australia Post remain vital to people living in rural and regional Australia. There has recently been significant improvements in electronic communications, but these are not yet fully available in rural and regional Australia and do not replace the need for a postal service that allows the interchange of physical items, such as health and educational material to people in remote areas.

In recent years Australia Post's role has expanded to provide a much broader range of services which, in many instances, are no longer offered by other service providers. These include financial facilities such as bill payment, banking services, money orders, passport applications and electronic lodgement of tax returns, in addition to postal related products such as parcel services which in many rural areas may be the only form of courier service.

As a result, rural communities rely far more heavily on the services provided by Australia Post than those in urban Australia.

There is general acknowledgment that Australia Post compares well internationally. The World Bank stated in 1996 that Australia Post ranked amongst the world's best performing postal enterprises, while Australia has one of the lowest basic postage rates in the OECD. A report released by KPMG showed that Australia Post continues to improve its on-time delivery performance.

In responding to the NCC's report on Australia Post, NFF expressed concern that the standard of current and future postal services in rural and regional Australia would be put at risk, notwithstanding assurances that the CSO would be maintained.

The NCC's proposal was at risk of only delivering benefits to a very narrow group within the community - large business users in metropolitan Australia. Small business and residential users in metropolitan Australia along with rural and regional Australia, stood to receive few if any benefits from the proposed reforms.

In turn, as noted in the NCC's report, deregulation of business mail and "cherry picking" of this high profit area would have meant that Australia Post would have difficulty meeting its CSO from internal revenue. NFF strongly opposed the NCC's preferred option of using budgetary funding to assist in paying for the CSO. Such a move put the level of the CSO at risk as a result of budgetary pressures, rather than an objective assessment of the need for the CSO. It would also have greatly increased the uncertainty in the provision of services for people in rural and remote Australia as well as having implications for future investment decisions in the postal network.

NFF also had concerns regarding other funding options, including a proposal to establish an industry levy to pay for the CSO. While the NFF does not oppose in principle such a method of funding, as is the case in the telecommunications industry, such an approach for postal services appears far less practical.

In addition, while we welcomed the NCC's recommendation that service standards for the USO be included in the *Australian Postal Corporation Act* 1989, to be monitored and enforced by the Australian Communications Authority, NFF was concerned that the current USO may not be sufficient to protect rural and regional postal services in a deregulated environment.

In particular, it is essential that the services standards include guarantees in relation to access to mail services, in addition to guaranteed standards of mail delivery. These guarantees in relation to access of mail services should ensure that all Australians continue to have the ability to access the full range of services currently provided by Australia Post in addition to receiving a delivery service if they choose.

Telstra

The privatisation of Telstra is part of the wider issue of the provision of telecommunications services to rural and regional Australia. The only reasonable starting point for any government policy on telecommunications is that all Australians should have equitable access to affordable quality telecommunications, products and services. This should not be limited to telephone, but should also include the essential data services required to participate in the Information Economy.

The quality and affordability of these services must be guaranteed by regulation and not subject to the whim of any carrier.

The quality of telecommunications services should be the same for all Australians. This includes issues such as time to connect a new service, time for repair and compensation penalties.

Rural and regional Australia will be disadvantaged if it does not have access to appropriate telecommunications services. This is particularly important for

agricultural producers, who compete in an increasingly competitive and technologically sophisticated international marketplace.

Legislation must be appropriate to ensure competition is alive and well in non-metropolitan Australia. Regional universal service providers must be able to enter the market easily and the existing network must be accessible on an affordable and equitable basis.

5 Infrastructure Reform

Because farmers, their families and many business that they buy from and sell to are located in rural areas, the viability of regional economies will depend on governments providing affordable access to modern economic and social infrastructure which most urban dwellers take for granted. Investment in regional infrastructure therefore is critical

In small rural towns, the key issues are the cost of accessing basic infrastructure services outside the local area such as education, where farm families have the additional expense of accommodation and other living away from home expenses, and the availability of local health, telecommunications and banking services.

In larger regional centres, the important issues are provision of transport infrastructure to allow the efficient delivery of local production to end markets, and first class social infrastructure to stem the drift to urban areas.

For all rural communities, affordable access to the latest information technology is an important aspect of reducing the tyranny of distance.

Significant effects flowing from NCP will be felt through changes to a range of utility services and government business enterprises. Within this area, the effects will be both positive and negative. They include the introduction of competition and the corporatisation of a number of government functions to improve productivity and reduce operating costs, and the removal of elements of price equalisation in a number of government utilities which currently limit the price differentials between urban and rural areas.

Whether the net effect of NCP will be positive or negative for the farm sector is unclear and will differ between government enterprises and between geographic regions.

Water Reform

A significant amount of capital is presently invested in Australia's water infrastructure. Variations in water availability, temporally and geographically, have focussed attention on issues of sustainability and rights to water use. Environmental issues have also added to the concerns.

The possibility of improved farm sector profitability as a result of water trading lies in differences in the returns per unit of water across farm produce, however the short and medium term impacts are likely to be lower profitability and possible loss of viability.

It is therefore important that reforms are phased in over a reasonable time period to facilitate adjustment of rural businesses and communities. During this phase in the involvement of growers and rural communities in the reform process will be vitally important.

Increased water prices will undoubtedly encourage economised usage transfer of water use to higher value agricultural products and more funds for maintenance. Water trading schemes will also encourage more efficient use of available water by allowing farmers who have water rights to sell them to other farmers who believe they could make profits in their area or industry by buying extra water allocations will be able to do so.

NFF supports a national set of water management reforms which should lead to the efficient operation of water markets and effective, more productive use of water resources.

However, water is a significant factor in Australia's agricultural competitive advantage and governments should recognise that higher water costs and loss of security in supply adversely affect agricultural competitiveness and regional development.

Large arbitrary increases in water prices and charges will also adversely affect input costs of agriculture.

NFF fully supports the need for property rights regime that is clearly defined, tradeable and provides security of supply of property rights which involves separation of the water right from ownership of land.

6 Competitive Neutrality

Competitive neutrality embraces the principle that government and privately owned businesses should be allowed to compete with each other on an equal footing, so that neither is advantaged by virtue of the nature of their ownership.

There have been a number of examples where government-owned businesses have had a quite unfair advantage over private sector competitors - one classic example was DASFLEET which, in some documented cases, was able to compete more than effectively with private sector operators such as Hertz and Budget because they incurred no capital cost on their fleet purchase - they bought their cars sales tax free and sold them for the purchase price.

The need for efficiency and cost minimisation is no less important in the local government function than it is in other sectors of the economy. Accordingly, where local government by-laws, regulations and business practices inhibit competition and provide the opportunity for inefficiency and excessive charging, this should be addressed by NCP. Where possible, subject to a rigorous analysis of the social and regional impacts, business functions should be subjected to competition, corporatised or privatised.

The heavy dependence of local government on revenue from land rates is highly inequitable and inefficient. The liability of individuals for local government taxes bears little relationship to capacity to pay or use of services and infrastructure. Accordingly, steps which reduce the dependence of local government on rate revenue and which charge for specific services and functions will improve equity. Tendering, corporatisation and privatisation of functions provides a transparent and open basis on which to desegregate revenues and to separate various independent cost centres in local government functions. NCP provides an opportunity for these reforms to be introduced in a process of reform that will improve both efficiency and equity in local government revenue raising.

Where a competitive market exists or can exist for the supply of services, these can be opened up to competitive tendering from external public or private businesses. However, it needs to be acknowledged that in many instances in rural areas, an effective competitive market in some services may not be possible. Where there is not a competitive market in the local area, the service may need to be treated as if it were a monopoly. In this case, corporatisation of the function within local government would be an appropriate action.

With government bodies, there is also the issue of not necessarily needing to make a profit (and pricing accordingly) and easier access of government bodies to finance.

A good case study for competitive neutrality in practice is provided by the local government industry in Victoria, where reform is generally agreed to be further advanced than in any other state.

Local government is very much a hybrid industry - a mixture of governance/regulatory functions and straight contestable service provision.

Typical Council services in Victoria include:

- Road and footpath maintenance and construction;
- Arts and leisure services (recreation centres, arts centres);
- Community services - maternal and child health, HACC Services, Adult Day Care, family day care;
- Garbage collection; urban maintenance (toilet cleaning, street cleaning etc.);
- Parks and gardens;
- Local laws (parking, animal nuisances etc.);
- Library Services;
- Statutory planning, building and environmental health functions;
- Internal governance and corporate services - IT, secretarial, finance, public relations, human resources management, asset and risk management, new project management (engineering), economic development, corporate and strategic planning; and
- Semi-commercial services such as quarries and saleyards.

Competitive neutrality found its first major expression in compulsory competitive tendering or CCT, which represented the opening up of previously closed and monopolistic local government services to private sector competition.

Other states had competitive tendering of local government services but it was generally not compulsory.

Implementation of this process began in mid-1995 after compulsory amalgamations that reduced local government organisations in Victoria from 210 to 78.

The requirement was that by 30 June 1997, 50 percent of Council expenditure had to meet CCT requirements.

In response most Councils split themselves into core client and provider sides. The client side was usually made up of core senior managers from the CEO down and they carried out core governance-type functions, managed the contracts or service agreements.

Some Councils administered the provider side as a separate single corporation while others reorganised themselves into a myriad of business units covering areas such as road maintenance, statutory planning etc.

Council teams then competed with the private sector for Council work and initially won about 75 percent of the contracts offered in the first round.

Amalgamation and subsequent savings from the CCT process resulted in a 20 percent across the board cut in rates plus several years of rate capping, a result which was a direct measurable benefit for farmers and other ratepayers.

There was an increased customer focus among Council employees while for businesses that won service agreements there was an incentive to maximise efficiency and broaden skills in order to stick to tender requirements.

This had benefits for employees who could share profits from hard work and innovation.

However the process has not been without criticism with suggestions that “in-house” teams had an unfair advantage in competing for work as a result of factors such as sales tax exemption and the fact that they did not have to factor a profit margin in to the contract price.

As a result, the next round of contracts will be tougher for in-house teams as the State Government now requires Council teams to factor in a market related rate of return.

As a result, disparate Council business units will probably band together as a single provider side corporation in order to take advantage of economies of scale. This larger more diverse organisation can more easily carry inefficient performers and may also dwarf some of its small business competitors.

There is also an increased risk to the Council and the community in the proliferation of contractors since the actions of a contractor can be more difficult to control than that of a direct employee resulting in reduced standards of service delivery and less accountability.

It can also result in identity problems externally and internally - do Councils service customers or the community?

There is also inevitable confusion among in-house staff - can staff be given direction by management or are they contractors, who perform to the wording of a contract rather than direction?

There is also confusion over what should be seen as core staff on the client side of the organisation - some organisations have opened up to competition

functions such as statutory planning, economic development, finance (accounts payable, rates etc.) and secretarial services.

In more remote areas, there is often an absence of available competition; also when an outside provider wins a contract a local workforce may be disbanded and replaced by outsiders, although this is usually not the case. Furthermore, those who have lost their jobs have less opportunity in remote areas to find another one.

7 Impact on Rural Services

Widespread and enduring drought, together with the early 1990s recession have impacted savagely on rural and regional Australia. This has occurred simultaneously with budgetary pressures on governments, tighter targeting of assistance and cut backs in government services. This has had a particularly adverse effect in rural and regional Australia, where people are doubly disadvantaged by distance and isolation.

The aim of competition policy as it applies to agriculture should be to facilitate efficient and market oriented rural and related industries focused on export opportunities. This will require government involvement in overcoming impediments to the efficiency of agricultural industries, together with strong, viable and economically diverse rural communities.

The maintenance of a viable commercial sector in regional areas is an important aspect of competition policy. Agriculture and the other business sectors it supports in regional Australia will face diminished international competitiveness if there is a decline in the efficiency of industries in rural areas.

It is not possible to examine regional effects of competition policy without value judgements about economic and population distribution. Government decisions play a significant role here. The trend in Australia is one of declining populations outside the capital cities and fewer regional centres. To a large extent, this has been supported by government decisions on investment in, and pricing of, infrastructure and public utilities and decisions on industry development.

There are some negative aspects of this trend that are becoming increasingly evident. The social problems of large urban cities are increasingly evident. These include the rising cost of urban infrastructure in major cities, national security doubts arising as our occupation of the majority of the continent becomes increasing scant, and congestion problems associated with locations of port facilities in major cities, amongst many others.

The delivery of services to rural and regional Australia is an area where competition policy is increasingly being viewed negatively.

Rural and regional Australia needs a reasonable level of services, particularly in roads, power and telecommunications and this will require substantial new investments in these sectors to keep these services at acceptable levels.

NCP has changed the way that decisions on new investments in these sectors are taken, and the way that funding is sourced, particularly for power and

7 Impact on Rural Services

Widespread and enduring drought, together with the early 1990s recession have impacted savagely on rural and regional Australia. This has occurred simultaneously with budgetary pressures on governments, tighter targeting of assistance and cut backs in government services. This has had a particularly adverse effect in rural and regional Australia, where people are doubly disadvantaged by distance and isolation.

The aim of competition policy as it applies to agriculture should be to facilitate efficient and market oriented rural and related industries focused on export opportunities. This will require government involvement in overcoming impediments to the efficiency of agricultural industries, together with strong, viable and economically diverse rural communities.

The maintenance of a viable commercial sector in regional areas is an important aspect of competition policy. Agriculture and the other business sectors it supports in regional Australia will face diminished international competitiveness if there is a decline in the efficiency of industries in rural areas.

It is not possible to examine regional effects of competition policy without value judgements about economic and population distribution. Government decisions play a significant role here. The trend in Australia is one of declining populations outside the capital cities and fewer regional centres. To a large extent, this has been supported by government decisions on investment in, and pricing of, infrastructure and public utilities and decisions on industry development.

There are some negative aspects of this trend that are becoming increasingly evident. The social problems of large urban cities are increasingly evident. These include the rising cost of urban infrastructure in major cities, national security doubts arising as our occupation of the majority of the continent becomes increasing scant, and congestion problems associated with locations of port facilities in major cities, amongst many others.

The delivery of services to rural and regional Australia is an area where competition policy is increasingly being viewed negatively.

Rural and regional Australia needs a reasonable level of services, particularly in roads, power and telecommunications and this will require substantial new investments in these sectors to keep these services at acceptable levels.

NCP has changed the way that decisions on new investments in these sectors are taken, and the way that funding is sourced, particularly for power and

telecommunications. The longer term issue for rural Australia is whether appropriate levels of investment in infrastructure will continue in this new environment. The longer term issue for government is whether a rundown in the infrastructure will reduce economic efficiency and productive capacity.

Under NCP the focus has shifted towards the costs of infrastructure investments and the returns that can be generated by the owners of the infrastructure and away from the community benefits. Competition has ensured that all infrastructure owners focus on financial returns and for rural areas this may create problems. The critical question in these circumstances is whether investments that are economically valuable will continue to be made, or what form of intervention is needed to ensure such investments are made, given the failure of the market to provide sufficient financial incentives.

The new emphasis on competition has sharpened the focus on costs and cost recovery leading to more efficient delivery of services, but risks overlooking the consideration of broader economic benefits. Dairy farms in Western Victoria provide a simple example. Upgrading of the power network may well be critical to the development of new dairies in the region. On current approaches to cost recovery such investment will only be marginally attractive at best to the power company. But the major beneficiaries of development of new dairy farms will not be the farmers, but the processors. Current figures show that value added by milk processors is almost three times the value added on dairy farms. How are these multiplier effects factored into investment decisions to create the environment where new (dairy) farms can be created or existing farms expanded?

The Productivity Commission needs to make a detailed examination of whether current competition policy is forcing too narrow a definition of costs and cost recovery and overlooking broader economic benefits, thus shutting off investment in rural infrastructure.

It is disputable that the nature of businesses and services in rural Australia has been changing as a result of factors such as falling world commodity prices, improved transportation, technological change, population shifts and cutbacks to government and private sector services.

For example, the Council's recent report on Australia Post (which supported opening the lucrative business-letter services market to competition) actually included 12 recommendations to increase services to the bush and strengthen guarantees that the services be maintained.

There can be little doubt that NCP will impact more heavily on rural and regional Australia and therefore increasing weight must be given to the benefits to all Australians of the maintenance of viable rural and regional communities.

8 The Public Interest Test

Implementation of the National Competition Policy program involves judgement about public costs and benefits.

Matters that need to be considered in the public interest test are diverse and frequently in conflict. For example, satisfying equity and social welfare criteria is frequently antagonistic to efficient allocation of resources. In addition the breadth of issues that are open for consideration implies a wide range of interested and affected parties.

The availability of choice is an important prerequisite to consumer sovereignty and is the mechanism by which consumer demand signals are transmitted to producers. In the absence of choice markets cannot function efficiently. The public interest test exercised in the context of NCP should, where applicable, support outcomes which give Australian consumers more choice rather than less, or which achieve an output with fewer resources and inputs rather than more.

Public interest tests will be required, inter alia, to determine whether to corporatise a government trading enterprise, to determine the nature of reforms to markets traditionally supplied by a public monopoly, and to determine whether State legislation should restrict competition in a particular market.

Clause 1(3) of the principles agreement lists the following matters which shall, where relevant, be taken into account in balancing benefits and costs, judging the merits of a policy or course of action or the means of achieving a policy objective:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity; and
- economic and regional development, including employment and investment growth.

The public interest test should be applied in a long term time frame. This allows all the implications of change to be fully considered and provides for issues of sustainability to be considered. In many instances, change involves a short term cost or disadvantage as a trade-off for perceived future benefits. If the total of the future benefits exceeds the adjustment or short term costs, then it is may be

in the public interest for the change to proceed providing that assistance or support can be given to those who suffer the short term costs.

The public interest test should be applied to the community as a whole and not to selective sectors or groups. A test that is not comprehensive will fail to capture all of the costs and benefits of an action and will be biased in the outcome it recommends.

In particular, defining the public interest in relation to legislation that restricts competition must be carefully considered.

It is too simplistic to look only at whether removal of legislation will lead to more competition or only at the effect on consumer prices. The assessment must be on a comprehensive measure of the net value of economic activity, including what return will come from resources that are displaced from their current activity, and whether removal of legislation will simply result in market power and economic returns being captured by another point in the value chain, with no change to prices and market structure.

In some instances, legislation confronts market power elsewhere in the chain as a result of economies of scale, barriers to entry, or control of information. The ultimate question is – will deregulation produce a market outcome that more closely emulates a perfectly competitive market than currently exists.

There is also the issue of the forum in which a consideration of the public interest may be assessed. These will vary in their openness, the opportunity for participation of the stakeholders and the detail in which issues are addressed. Cost will also vary according to the nature of the chosen forum. As a general rule the more complex the matter under consideration, the larger the costs and benefits of the policy that is under review and the more diverse the stakeholder groups, then the more open and detailed the inquiry should be.

Agriculture must be allowed the flexibility to organise itself to compete on the international market, take advantage of emerging opportunities, and elevate itself beyond the status of a producer of raw undifferentiated commodities.

NCP regulates the competitive process and provides a deterrent against anticompetitive firm behaviour which is thought to lead to large efficiency losses or disadvantage consumers or small firms. Implementing such policy is not straightforward because there are typically benefits and costs which have to be weighed in assessing the effects of particular market structures or conduct. Furthermore, the informational requirements of competition enforcement can be considerable due to the need to assess all aspects of the economic environment in which firms operate.

Economic theory does not provide policy makers with a set of 'optimal' competition rules or give clear guidance on an 'optimal' industrial structure.

Countries have consequently implemented competition regimes which best match their priorities while still remaining within the broad guidelines provided in economic theory. As a result, there is considerable divergence between countries in how competition policy occurs in practice.

NCP reforms of production sectors should only be undertaken if accompanied by reforms of anti-competitive (but not necessarily regulated) structures elsewhere in the marketing chain.

9 Community Service Obligations

The notion of Community Service Obligations (CSOs) is closely related to NCP. CSOs arise in a range of areas, including access to health services, provision of water, sewerage and electricity, telecommunication services, quarantine services, education, banking, public transport and mail services.

CSOs are a minimum service standard commonly held by the community to be a right of every member of the community, but which may not be automatically delivered in a competitive private market. CSO delivery does not need to be the sole preserve of government business enterprises; they may be delivered by private or public sector providers. Where functions are privatised or opened to competition, governments will need to retain some form of control that ensures that private providers do not breach the defined CSO standard.

The decision that a service provider has an obligation to the community cannot be divorced from the question of how provision of that service should be funded. A decision to provide a service as a CSO implies that the cost of the service will be shared by the community and that the service will not be denied to individuals because of cost, circumstances or geographic location. There is also an implied commitment that the standard of the service will remain relatively constant over time. However, in utilities such as electricity, water and telephones, where the amount of use is highly optional and there is potential for wastage, unit charging will have a role in discouraging wastefulness, uneconomic use and overuse. In other circumstances where there is less choice about consumption, such as education or health, pricing may be more concerned with affordability than limiting overuse.

Significant pricing differences already exist in some of these services between rural and urban areas, and this is a major disadvantage to regional communities and the competitiveness of regional industry and therefore regional employment opportunities.

In all services that embody a CSO, there is a degree of essentiality that underpins the service obligation. They are seen as necessary and important aspects of a minimum standard of living guaranteed by the community. In order that these services are reasonably available to all in the community, pricing must take into account the ability to pay of those in the community. This does not require that pricing always meet the needs of the least well-off, (special arrangements may be made for some groups), but pricing must ensure that the service is affordable to the overwhelming majority of the population.

10 Conclusion

Review of regulations governing competition demands more than indiscriminate dismantling of regulation. Developing more competitive markets requires careful design of regulatory systems that acknowledge the nature of the products, the participants and the markets in question, so as to produce outcomes that are efficient and maximise economic benefits. It should be noted that some of the most efficient and competitive markets (for example, equities) are, in fact, heavily regulated to protect the interests of participants.

It is also important that reform extends to all areas of anti-competitive regulation in order to generate the full measure of benefits to the economy. Should reform address only some areas of competitive failure and not others, then only some industries will benefit and these may not necessarily be those in which Australia has a comparative advantage.

NCP requires that governments systematically review all regulatory intervention that inhibits competition, to determine whether they deliver a public benefit. For agriculture NCP has its most direct impact on SMA's.

These arrangements have been characterised by ongoing change in response to market conditions. It should be acknowledged that there has been substantial change in many agricultural marketing arrangements in recent years. Reviews must be undertaken on a case-by-case basis, and in a manner that recognises differences between products, in areas such as perishability, definable and measurable quality parameters, buyer concentration and foreign government intervention in markets, and the implication of these factors on market structure and market efficiency.

Consideration should also be given to the order in which areas of anti-competitive regulation are reviewed, as this will dictate the process of adjustment of commercial activity and movement of resources. In broad terms, regulation that reduces competition in basic factor markets, such as land, labour and capital, should be dismantled first, followed by anti-competitive intervention in widely consumed utilities and services. After reform has occurred in these areas, action can be taken to dismantle intervention in markets for goods, which are produced from these factors, and services. This minimises the extent to which double adjustment problems will emerge that would increase the overall adjustment cost.

The review of anti-competitive regulation should be accompanied by ongoing review in areas of taxation, tariffs, and the labour market. The potential gains from removal of government intervention are unlikely to be fully realised if this does not occur.

Community service obligations are an integral part of the system of all levels of government in this country. NCP has reinforced and encouraged a greater awareness and systematic evaluation of CSOs. The delivery and funding of CSOs should be assessed on a case-by-case basis. Attention should more strongly focus on their ongoing transparency and relevance, with appropriate reporting and monitoring systems for CSOs being implemented.

Finally, it is critical that there is adequate public education and consultation about the reforms, and their progress. Such public education arrangements should have been put in place earlier, by all agencies involved in implementing the reforms. The role of the NCP is increasingly viewed as poorly defined, with benefits that are national rather than tangible and the public benefit test is value. Above all, the process lacks the one element that the Government is so fond of – transparency.

This inquiry provides such an opportunity. In order to increase transparency and facilitate understanding of NCP, it would be beneficial for the Productivity Commission to publish a draft report for comment before finalising its report to Parliament.