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Mr John Cosgrove
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Impact of Competition Policy Reforms Inquiry
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Dear Mr Cosgrove

INQUIRY INTO THE IMPACT OF COMPETITION POLICY REFORMS ON RURAL AND REGIONAL AUSTRALIA

Please find attached the South Australian Government's submission in response to the draft report of the Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia.

This submission has been endorsed by Cabinet and was prepared by an interdepartmental working group which consisted of: Premier & Cabinet (chair); Treasury & Finance; Industry & Trade; Transport, Urban Planning & the Arts; Administrative & Information Services; Environment, Heritage & Aboriginal Affairs; and Primary Industries & Resources.

As requested by you at the meeting with the working group on 22 June in Adelaide, the submission provides detailed examples to illustrate South Australia's concerns with the way NCP is being implemented. Copies of the documents referred to in the submission can be provided on request.

The submission indicates that South Australia has significant concerns with draft recommendations 5, 6, 8 and 9. The submission also comments on other issues in the draft report, and corrects minor errors.

Please contact Dr Rosemary Ince, A/Director – Economic Reform Branch (tel 8226 0902, fax 8226 1111) if you have any enquiries on this submission.

Yours sincerely

JOHN OLSEN
Premier

9/ 8 / 99

SA GOVERNMENT RESPONSE TO THE PRODUCTIVITY COMMISSION DRAFT REPORT INTO THE IMPACT OF COMPETITION POLICY REFORMS ON RURAL AND REGIONAL AUSTRALIA

AUGUST 1999

1. INTRODUCTION

SA reiterates its view that there needs to be provision for greater flexibility in the implementation of National Competition Policy (NCP).

The implementation of NCP has turned out to be a much larger task than was originally envisaged, with significant transitional issues. Electricity reform is a classic example of an agreed reform that was more complex than originally predicted, with the start date of the national market being deferred several times.

NCP has also turned out to have some adverse effects that were not predicted when the Intergovernmental Agreements were signed in April 1995. Competition reforms were supposed to improve the overall welfare of the Australian community, including through job creation. Modelling performed by the Industry Commission in 1995 estimated an increase in employment of 30,000 positions. The second reading speech in the Commonwealth Parliament on the Competition Policy Reform Bill 1995 also stressed the job creation aspect. From modelling performed by the Productivity Commission for this inquiry, it would appear that competition policy is creating output growth without employment growth. This is unlikely to satisfy community concerns with competition policy.

The modelling in the draft report shows that the employment impact of reforms is falling disproportionately on South Australia. While NCP is modelled to have a negative effect on employment in 34 of the 57 regions in Australia, this is the case for 6 of the 7 regions in SA. ('Negative' does not necessarily mean an absolute reduction in jobs, but that employment is lower than it would otherwise have been in the absence of NCP.) Adelaide was SA's only region estimated to have an NCP-induced increase in employment.

The modelling also shows that, of the overall increase in production estimated to be generated by competition reforms, approximately 80% will be gained by NCP reforms to the electricity and gas sectors and by reforms that pre-date NCP in telecommunications. These reforms have largely already been implemented in South Australia. Some flexibility in the implementation of the remaining parts of the NCP reform package would allow South Australia to effectively manage its administrative resources and any adverse transitional impacts. This would be unlikely to have any substantial adverse impact on national or State output, as the remaining NCP reforms are estimated by the Productivity Commission to have relatively little overall impact on output, but it would provide an important opportunity to manage adverse public perceptions regarding competition reforms.

2. COMMENTS ON RECOMMENDATIONS IN DRAFT REPORT

The numbering of the recommendations is as in the overview section of the draft report.

2.1 RECOMMENDATION 1

All governments should review the information they provide about their National Competition Policy undertakings in the year 2000 with a view to ensuring that it is:

- **accurate in terms of both content and relationship to other policies; and**
- **is publicly available and is provided to those implementing National Competition Policy reforms in a readily accessible form.**

SA already provides this information, and therefore has no plans for such a review.

2.2 RECOMMENDATION 2

All governments should publish and publicise guidelines which:

- **outline the purpose and scope of the 'public interest' provisions of the Competition Principles Agreement; and**
- **provide guidance on how the provisions may be interpreted and applied.**

In the event that a common set of basic principles for application of the public interest test is developed jointly by governments, these also should be published and disseminated widely.

There is widespread lack of understanding that the purpose of NCP is to improve community welfare, and that Governments are not obliged to undertake reforms unless those reforms are in the public interest.

South Australia first proposed that NCP implementation issues, including public understanding of the reforms, be discussed at the Premiers' Conference on 20 March 1998. The Prime Minister considered the timing inappropriate, and SA therefore raised its concerns about the lack of public understanding of the nature and benefits of competition policy at the 22 May 1998 meeting of COAG Senior Officials, and again at the 11 December 1998 meeting.

At the December 1998 meeting the National Competition Council (NCC) outlined an extensive communication plan which it proposed be funded by States and Territories. Senior Officials instead commissioned expert advice on the development of a communications strategy for NCP. A report was provided by Artcraft Research and Barclay Consulting for the 12 March 1999 meeting of Senior Officials.

The consultants' report makes plain the low level of public understanding of, and support for, NCP. The credibility gap is so large as to be very difficult now to overcome. While SA will continue to make available its various sets of NCP guidelines, including on its website, it would be naïve to suggest that these could turn around the public's perception. The damage is already done. The consultants were prepared to canvass the possibility that NCP needed to be rebadged if it was to continue.

On 29 April 1999 the Commonwealth advised that it would provide $200,000 pa for two years to fund a communication unit in the NCC. (Note that, under clause 8 of the Competition Principles Agreement, it is the Commonwealth's responsibility to fund the NCC.)

South Australia suggests that the Productivity Commission reflect the consultants' findings in any recommendations concerning publicising NCP.

One of the strategies used by the NCC to 'sell' NCP, and also found in the Productivity Commission's draft report, is to label benefits from reforms that pre-date NCP as benefits of NCP. While appreciating the difficulty of separating NCP from other micro economic reforms, to claim (see table on p. xxxiii) that a 17% reduction in the real price (all customers) of electricity in SA between 1991/92 and 1996/97 is a benefit of NCP is simply misleading. The figure for SA was in fact taken from the Productivity Commission's report on Performance of Government Trading Enterprises 1991-92 to 1996-97.

2.3 RECOMMENDATION 3

Governments should require major legislation review panels to ensure that their reports go further than simply determining compliance or otherwise with NCP principles. Reviews should be based on genuine public input, be conducted in a transparent manner and inform interested parties why and how reform, or maintenance of the status quo, will lead to superior outcomes and performance.

South Australia has adopted legislation review guidelines that reflect these criteria. The guidelines are publicly available. No major SA review has been alleged to contravene the State's guidelines.

On 20 May 1999 the Premier wrote to the Prime Minister in relation to the national review of pharmacy to express SA's concern that the proposed independent chairperson was an ex pharmacist and had previously been employed in the pharmaceutical industry. SA considered that he lacked the necessary independence from vested interests. SA's concerns were acknowledged by the Prime Minister's response dated 15 June 1999 but the appointment proceeded regardless.

2.4 RECOMMENDATION 4

In the case of reviews of anti-competitive legislation which may have significant impacts extending across jurisdictions, the benefits and costs should be weighed in terms of the interests of Australians as a whole.

In arguing for a more flexible approach to implementation, the original South Australian submission (see *4.1.3 Differences between and within jurisdictions*) used nationally uniform vehicle mass and dimensional limits as an example. In this instance, SA is taking a stance which supports SA interests but which can also be justified by national interest considerations. Despite this, the draft report implicitly criticises SA by supporting the contrary Victorian position.

SA's original submission stated

> "As presently drafted, there are requirements under national road transport reforms to adopt upper limits on vehicle mass and dimensions, even though local roads and

> bridges may be capable of taking vehicles with higher or larger loads, thus increasing transport efficiency. For example, Victoria has objected to South Australia's permission for the transport of citrus fruits to the Port in larger containers, even though this transport is critical to the international competitiveness of produce which is vital to the viability of the Riverland regions of the State. This example illustrates the risk of national uniformity imposing inappropriate standards, based on the operating conditions in more populous States and regions, to the disadvantage of rural and regional Australia. States should be allowed to tailor regulatory requirements to suit the local conditions in their various regions, rather than slavishly adhering to national uniformity."

The Productivity Commission appears to have misunderstood this argument, instead supporting the Victorian point of view (see p. 146):

> "A transport operator in Mildura claimed that, because only Victoria has enforced the uniform mass limits strictly, his competitiveness had declined compared with operators from other States where more latitude is given."

Victoria has chosen to impose a rigid upper limit on the mass and dimensions of heavy vehicles in all circumstances. By contrast, South Australia's approach is more in keeping with the guiding principle in clause 5 of the Competition Principles Agreement This State has no upper limit; individual permits may be given for any overmass or overdimension vehicles to operate on roads, where the costs of doing so for the community as a whole do not exceed the benefits. It is the blanket restriction on competition imposed by the Victorian regulatory approach which places its operators at a competitive disadvantage relative to South Australian operators, rather than any inappropriate action on the part of South Australia.

South Australia reiterates its view that the setting of upper mass limits should be done in relation to the design and condition of the roads and bridges and the nature of the traffic on the particular route in question. If some South Australian roads can appropriately accept higher mass limits, with the productivity benefits this implies, then artificially imposed uniform mass limits are inappropriate. Where there are no overriding safety or infrastructure reasons to prevent further local increases in mass limits, it would be highly unlikely that the South Australian Parliament or Minister for Transport and Urban Planning would not continue to support such increases.

The force of this argument has now been accepted by the National Road Transport Commission and Transport Agency Chief Executives. The purported upper limit for permits was included in national road transport reforms without the preparation of a Regulation Impact Statement covering this issue. This restriction is now to be reviewed by the NRTC, at the instigation of South Australia.

For Victoria to argue, and the Productivity Commission to support, a position which seeks to protect Victorian primary producers and transport operators, to the detriment of more efficient production and transportation in South Australia, is illogical and unjust. This is especially so when the draft report identifies that the full implementation of road transport reforms "would increase GDP by more than $1.2 billion a year, with around two-thirds of this gain arising from the Mass Limits Review proposals" (p. 147). South

Australia fully recognises the importance of road transport reform, and has been a leader in the introduction of many significant productivity reforms. For example, South Australia was the first jurisdiction to adopt the higher mass limits on gazetted routes, in accordance with a proposal which Transport Ministers have had under consideration for some time. This State adopted the higher mass limits, (which operate as-of-right, ie with no obligation to apply for a permit) on appropriate routes on 1 January 1999, 6 months in advance of the roll out of this reform in Victoria. Rather than being criticised for failing to follow the restrictive policies of its neighbours, South Australia should be congratulated for its progressive and productive approach to road transport reform.

South Australia suggests that the final report should be amended to reflect that it is the South Australian practice in relation to road transport reform which accords with Recommendation 4, not that of Victoria in this specific instance..

2.5 RECOMMENDATION 5
The National Competition Council should no longer be asked to conduct legislation reviews.

The draft report includes comments from South Australia which support a transparent separation of the NCC's role as adjudicator of competition payments from its role as a policy-maker following review of Commonwealth legislation (pp 332-334). While SA therefore supports Recommendation 5, it is too narrowly focused on just part of the problem as perceived by several States and Territories.

South Australia considers that there is an inherent conflict between the NCC's role as a champion of competition policy reform, and its role in assessing progress by jurisdictions for competition payments. The NCC has attempted to push out the boundaries for reform by including, in the competition payments assessment process, matters that did not form part of the Inter Governmental Agreements on Competition Policy signed in April 1995. There are now many examples of this 'creep' including -

Water reforms. The NCC President's letter of 19 June 1998 to Heads of Government and the NCC's second tranche assessment framework distributed on 16 November 1998 went beyond the Strategic Water Reform Framework approved by COAG in February 1994 by requiring that Community Service Obligations be "well targeted and justifiable" as well as explicit and transparent. The Premier wrote to the NCC on 14 November 1998 outlining SA's concerns and seeking bilateral negotiations. Several other jurisdictions also conducted bilateral negotiations with the NCC. A tripartite meeting organised by Senior Officials took place on 14 January 1999 between the NCC, the SCARM High Level Steering Group on Water and the COAG Committee on Regulatory reform in an attempt to resolve this issue (discussed further below).

Road transport reforms. This issue came to the fore as a result of the letter dated 11 March 1998 from the NCC President to Heads of Government in which the NCC stated that Governments agreed to the Ministerial Council on Road Transport timetable of 14 February 1997 being used as the basis for the NCC's second and third tranche assessments. The NCC included the 14 February 1997 timetable in its updated (June 1998) Compendium of NCP Agreements, despite SA pointing out to the NCC that this

and other 'agreements' in the compendium did not give rise to NCP obligations. Jurisdictions referred the clarification of the scope of road transport reforms to Senior Officials. Agreement on assessable reforms was reached by the Australian Transport Council on 4 December 1998, and forwarded to COAG for approval. SA's concerns were addressed through this process.

Conduct Code compliance. The NCC's second tranche assessment framework stated that the NCC required confirmation that the notification of section 51(1) exemptions under the Trade Practices Act was "to the satisfaction of the ACCC". The obligation under clause 2(3) of the Conduct Code Agreement is to "send written notice to the Commission". This was done by SA in July 1998 and no concerns were raised by the Australian Competition and Consumer Commission. Accordingly SA considered that its obligation under the Conduct Code Agreement had been met.

Gas reforms. At the Energy Markets Group (EMG) on 15 December 1998, SA pointed out that the NCC stated in its second tranche assessment framework forwarded to jurisdictions on 16 November 1998 that (p. 28) it "will also consider progress by jurisdictions in addressing ... any regulatory or legislative barriers identified by the Upstream Issues Working Group". Given that the Premier wrote to the Prime Minister on 17 March 1998 seeking assurances that work by the Upstream Issues Working Group would not be linked to competition payments, receiving a reply dated 27 April 1998 that said "I do not envisage that consideration of these issues by the Working Group will result in new conditions or benchmarks for competition payments", this continued attempt by the NCC to expand jurisdictions' competition policy obligations was of serious concern.

The meeting agreed that the chair of EMG would express EMG's concern to the NCC President. The matter was settled by a letter dated 30 March 1999 from the Commonwealth to the NCC.

Gambling legislation. The NCC criticised SA and several other jurisdictions on gambling, initially for failing to include gambling legislation in review timetables, and then for conducting reviews which failed to justify monopoly licences for TABs and casinos. The NCC did not accept arguments that these are social policy rather than competition policy issues. While the NCC subsequently acknowledged that these are complex and sensitive issues, and did not impose any penalties in the first tranche assessment, it stated that it would consider gambling legislation in its future assessments.

Regulation of professions. In March 1998 the NCC put forward a proposal to regulate all professions under the Trade Practices Act. This was despite the requirement under the Intergovernmental Agreements that all additions to the NCC's work program should be approved by jurisdictions.

The meaning of satisfactory progress. In conducting its assessments, the NCC has interpreted "satisfactory progress" to mean jurisdictions meeting almost all their obligations rather than a significant proportion. This is an unusual interpretation of "satisfactory". For example, the NCC's June 1999 draft assessment report for the second tranche of competition payments implied that the NCC proposed to penalise SA by $24 million per annum for lack of progress on deregulation of shop trading hours. The

proposed penalty for this one breach would have been around two thirds of the relevant competition payment to SA for 1999/00. It would also have been premature, as the timeline set by the Competition Principles Agreement for legislation review and reform is December 2000. (In the July 1999 assessment, as forwarded to the Federal Treasurer, the NCC stated that it will consider an annual deduction from SA's competition payments if restrictions on retail shop trading hours are not removed or shown to be in the public interest, by 31 December 2000.)

Apart from the financial implications of the way the NCC has discharged its role, its behaviour may have an adverse effect on policy making. Jurisdictions will be reluctant to commit to ambitious reforms if they fear that these will be interpreted by the NCC as NCP obligations for assessment purposes. Jurisdictions are also likely to approach their agreed NCP obligations in a spirit of short-term compliance rather than long-term commitment to genuine reform.

SA's position is that reforms which post date the April 1995 Agreements should only be assessable by the NCC if COAG has explicitly included them in the competition payments assessment process. The NCC's position, as expressed in its letter to SA dated 7 July 1998, is that later reforms are 'in' the assessment process unless COAG has explicitly excluded them. Given the infrequency of COAG meetings, and the highly technical nature of some of the reforms, the NCC's position would considerably lengthen the list of reforms that are assessable for competition payments purposes.

SA notes the statement on p. 185 of the draft report that "The NCC does not reject or modify reviews". It is hard to reconcile this statement with the NCC's response to SA's review of its Southern State Superannuation Act 1994 ("SSS Act"). SA published the review report as an appendix to its March 1999 report to the NCC. The NCC's response in its June 1999 draft assessment report was that it did not accept SA's argument that the SSS Act had only an insignificant ("trivial") effect on competition. However, the NCC did not provide any rigorous analysis, merely referring to the Commonwealth's proposed "choice-of-fund" legislation and to "reforms" proposed by other jurisdictions.

SA responded in detail to the NCC's points, stressing that the total volume of economic activity that is "tied" by the SSS Act, and which could therefore potentially provide a sub-optimal economic outcome, is 5 staff positions and associated computer assets, software, and office space, etc. SA requested that, if the NCC remained dissatisfied with SA's analysis, the NCC should set out the market information upon which it has based its difference of opinion.

In the assessment report published in July 1999, the NCC continues to state that it is not clear to the NCC that there are only trivial restrictions on competition, as South Australia has argued. The NCC states that it wishes to ascertain by the end of 2000 that any non-trivial restrictions provide a community benefit. SA accordingly considers that the NCC has rejected its review report of the SSS Act.

South Australia suggests that the final report should amend Recommendation 5 to acknowledge more fundamental concerns about the NCC's role than just whether it should continue to conduct reviews of Commonwealth legislation.

2.6 RECOMMENDATION 6

The Commission recommends that there should be no across-the-board extension of the NCP target dates.

SA disagrees with this recommendation for two reasons.

One is that approximately 80% of predicted GDP growth from NCP-type reforms comes from reform of electricity, gas, and telecommunication industries. Nationally, of real GDP growth of 2.59%, the reform of electricity and gas has been modelled to provide an increase of 1.16% and reform of telecommunications 0.83%. For South Australia, the modelling estimates an increase in GSP of 2.31%. Electricity and gas reforms are modelled to provide 1.01% and telecommunications 0.89% of this growth.

These reforms, in electricity, gas, and telecommunications, have largely already been implemented in South Australia. The other infrastructure reforms, which are modelled to have a much smaller impact on GDP, are also largely on schedule.

While South Australia is well-progressed in carrying out the remaining parts (eg legislation review, competitive neutrality) of the NCP reform package, some flexibility in implementation would allow SA to effectively manage its administrative resources and any adverse transitional impacts. This would be unlikely to have any substantial adverse impact on national or State output, as the remaining NCP reforms are estimated by the Productivity Commission to have relatively little overall impact on output, but it would provide an important opportunity to manage adverse public perceptions regarding competition reforms.

The other reason is that the basis for this recommendation is the statement in the draft report (p. xxxi) that "Control of NCP rests with governments and ... they have used forums and processes to ... modify NCP implementation schedules. The evidence suggests that these procedures are working." SA strongly disagrees that the existing processes are working satisfactorily, and provides the following information about water Community Service Obligations (CSOs) as an example.

As the Productivity Commission itself notes (p. 80), NCP does not require the removal of CSOs. The problem is that the NCC does.

As noted above, the NCC President's letter of 19 June 1998 to Heads of Government and the NCC's second tranche assessment framework distributed on 16 November 1998 went beyond the Strategic Water Reform Framework approved by COAG in February 1994. When COAG reached agreement on national competition policy in April 1995, the 'Agreement to Implement the National Competition Policy and Related Reforms' linked competition payments to, among other conditions, implementation of the COAG Strategic Water Reform Framework.

The Framework covers water pricing, including the treatment of cross-subsidies. The Framework allows for transparent subsidies consistent with clause 3(a)(ii) of the Framework which is "... that where service deliverers are required to provide water

services to classes of customer at less than full cost, the cost of this be fully disclosed and ideally be payed (sic) to the service deliverer as a community service obligation".

The NCC's interpretation, as set out in its letter of 19 June 1998, that the Strategic Water Reform Framework required CSOs to be "well targeted and justifiable" as well as explicit and transparent would, if unchallenged, have presented a very real threat to maintaining the community service obligation which establishes a state-wide price for water in SA.

South Australia raised the need to clarify the scope of water reforms for purposes of competition payments at the Senior Officials meeting on 22 May 1998. Senior Officials agreed the matter needed attention, and referred it to their Committee on Regulatory Reform. However, the Committee on Regulatory Reform which is chaired by NSW did not address the issue despite the SA member of the committee urging that this happen. The Chief Executive of the Department of the Premier & Cabinet wrote to the chair of the Committee on Regulatory Reform on 5 November 1998 to express his concern at the lack of action.

At the 11 December 1998 meeting of Senior Officials, the matter was again referred to the Committee on Regulatory Reform for action, and this led to the tripartite meeting on 14 January 1999 (parties present were CRR, NCC, and the SCARM High Level Steering Group on Water). At the tripartite meeting, all jurisdictions except SA accepted a proposal to allow for continuation of schemes which do not recover full costs, provided there are only a "small number" of such schemes. SA's concern was that, while its rural water CSO is a single scheme, and thus allowable, the NCC might argue that the CSO comprises several individual schemes. As the purpose of Senior Officials' involvement and the tripartite meeting was to clarify obligations, SA's view was that the interpretation risk should if possible be avoided.

This interpretation risk had been commented on by the SA Auditor-General in his 1997/98 report.

Following the tripartite meeting, SA came under significant pressure from other jurisdictions, and in particular the secretariat in the Commonwealth Department of Agriculture, Fisheries & Forestry, to give way so that the tripartite meeting could reach consensus. The secretariat also attempted to represent the purpose of the tripartite meeting as being confined to timetable issues rather than issues of interpretation.

The tripartite meeting had agreed that information about CSOs would be supplied to the NCC but could not be used by the NCC for assessment purposes. The 5 February 1999 draft of the record of the tripartite meeting is attached to make the point (see recommendation 4.2) that the NCC continued to try to establish a role for itself in assessing CSOs.

SA also queried whether – even if the information could not be used for assessment purposes – SA should be explaining and justifying its water CSOs to the NCC as opposed to ANZECC or ARMCANZ. Not only is this not the NCC's role, the NCC appears to lack the necessary expertise in water matters. SA had been concerned by the serious misrepresentation of a water quality incident in Adelaide in the NCC's January 1999 report 'NCP: some impacts on society and the economy'. The NCC apparently used the

report in its submission to this Productivity Commission inquiry. In the report the NCC likened the discovery in 1998 of cryptosporidium and giardia in Adelaide's raw water to the Sydney water crisis and the Longford gas disaster.

The Minister for Environment & Heritage's letter to the NCC setting the record straight is attached.

The report of the tripartite meeting was considered at the 12 March 1999 meeting of Senior Officials. The meeting accepted SA's position on CSOs and resolved to delete the "small number" provision *but* the draft minutes made this decision subject to endorsement by the NCC and again misrepresented the exercise as one of making revisions to the timetable only. SA took these matters up with the chair of Senior Officials and the secretariat. As the Commonwealth had already sought the NCC's endorsement, that step could not be retracted, but SA's position that it was the entire report of the tripartite meeting that needed to be considered by COAG was reflected in the Prime Minister's letter to Heads of Government dated 7 April 1999.

It is not known whether all Heads of Government have yet replied in the affirmative to the Prime Minister's letter.

Thus it took a year of high level effort, using forums established for this purpose, for SA to 'clarify' that it would not be required by the NCC to go beyond the commitment it made in February 1994, and which became an NCP obligation in April 1995, that its water CSOs would be explicit and transparent.

It is apparent from other developments, besides the issue of water CSOs, that the NCC does not accept that CSOs are a legitimate policy tool of governments. In its June 1999 draft assessment report, the NCC criticised SA's handling of a competitive neutrality complaint involving CSOs. SA responded in detail and corrected some of the NCC's misunderstanding but the redraft of the assessment report used clause 3(1) of the CPA to again focus on CSOs and competitive neutrality. The NCC stated that

> "There may be alternative means of realising the objective of a CSO, such as tendering the service or distributing entitlements direct to users, which .... satisfy more confidently the objective of [competitive neutrality] .... Governments should examine the costs and benefits of alternatives .... This is consistent with the resource allocation objective in CPA clause 3(1)."

SA responded that the obligations on Governments under competitive neutrality are contained in clauses 3(4), 3(5) and 3(8)-(10) of the Competition Principles Agreement. While the SA Government's CSO policy framework recognises that there are a number of options for managing CSOs, there is no obligation under NCP, assessable by the NCC, that costs and benefits of alternatives of executing CSOs will be examined.

The very nature of a CSO is that it gives rise to a misallocation of resources – that is, it is non-commercial in nature. For example, social security recipients use more electricity than they would otherwise be able to afford, because they receive a rebate. The NCC should not be allowed to delve into CSOs – provided they are explicit and transparent – under the guise of applying clause 3(1) of the Competition Principles Agreement.

South Australia suggests that Recommendation 6 and supporting text be amended to reflect the difficulty experienced in modifying NCP implementation schedules.

South Australia suggests that the report acknowledge that Community Service Obligations are a legitimate policy tool of Governments.

2.7 RECOMMENDATION 7

CoAG should give consideration to the formal extension of the rural water reform timetable for the implementation of water property rights and environmental allocations.

Water property rights are not an issue for South Australia given the existence of the *Water Resources Act*. An extension of the water reform timetable with respect to water allocations for the environment was agreed at the 'tripartite' meeting held on 14 January 1999. An extension beyond the agreement made at that meeting is not supported at this time.

2.8 RECOMMENDATION 8 & 9

RECOMMENDATION 8 If governments consider that specific adjustment assistance is warranted to address large regionally concentrated costs, such assistance should:

- **facilitate, rather than hinder, the necessary change;**
- **be targeted to those groups where adjustment pressures are most acutely felt;**
- **be transparent, simple and of limited duration; and**
- **be compatible with general safety net arrangements.**

And

RECOMMENDATION 9 Governments should rely principally on generally available assistance measures to help people adversely affected by NCP reforms.

These recommendations relate specifically to transitional costs associated with the implementation of competition policy reforms. The inquiry into the impact of NCP on rural and regional Australia was initiated by the Federal Treasurer, and one of the four terms of reference on which the Productivity Commission was specifically asked to report was:

> "any measures which should be taken to facilitate the flow of benefits (or to mitigate any transitional costs or negative impacts) arising from competition policy reforms to residents and businesses in regional and rural Australia."

Given that the Inquiry was initiated by the Commonwealth Treasurer, it is curious that the Productivity Commission should recommend that transitional costs be borne by State

governments. While Recommendations 8 and 9 do not specify which governments should be making transitional aid payments, the text of the draft report is clear (p. 339-40):

> "The arguments in support of specific adjustment assistance indicate that, if warranted, is [sic] should be provided on a case-by-case basis. This means that individual assessments would be required and that the additional assistance provided should address the particular circumstance and be delivered at a State level. The Commission notes that the States have been provided with significant funding for the implementation of NCP. Accordingly, it seems reasonable that they should play a role in funding any special adjustment assistance packages."

The suggestion that the 'buckets of money' given to the States by the Commonwealth as part of the NCP package should be used by the States to fund transitional cost arrangements takes no account whatsoever of the nature of the payments, the level of the payments, the high cost to State governments of conducting legislative reviews and implementing associated NCP reforms, and, most importantly, the reasons why the monies were earmarked by the Commonwealth for the States in the first place. They were intended to represent a sharing of the benefits of increased government revenue derived from productivity improvements, rather than as funding for implementation.

Some consideration should also be given to the need for a national scheme to transfer funding to those regions of Australia which are detrimentally affected by the implementation of reforms designed to benefit "Australians as a whole".

South Australia does not seek to avoid economic reform, but rather to implement it based on the unique set of circumstances that exist in South Australia relative to the rest of the nation, especially in the regional and rural areas of South Australia. While the net gains from NCP are likely to be positive for South Australia as a whole, they are most definitely proportionately lower relative to other States.

The socio-economic problems, unrelated to competition policy, that agricultural dependent communities across Australia are having are being fully experienced in South Australia. Regions experiencing a trend of declining employment opportunities, whether inclusive or exclusive of the impacts of NCP, are disproportionately higher in South Australia.

As 6 of the 7 regions in South Australia are likely to experience a negative impact on employment growth from NCP, this may lead to a widening gap in the unemployment rate between South Australia and the national average (South Australia's unemployment rate of 8.3% was 0.8 percentage points higher than the national average in April 1999 – seasonally adjusted).

The data in the draft report makes clear the need for a strategy to overcome substantial socio-economic problems in regional and rural Australia.

The core socio-economic problem in regional and rural areas is an absence of non-farm employment opportunities to absorb young workers entering the job market for the first

time or to absorb the mature workers that leave agricultural production due to changes in technology and economies of scale.

A strategy to resolve the socio-economic problems in regional and rural Australia should not, in the main, be based on continuation of cross-subsidies. Anti-competitive cross-subsidies have not resolved the socio-economic problems of regional and rural areas and will not do so if continued.

In regional and rural areas that are now heavily dependent on agricultural production, employment problems must be solved primarily outside of existing employment patterns. New types of jobs in economic activities other than agricultural production will be needed.

South Australia has taken an initiative, through its newly formed Office of Regional Development, to address the socio-economic problems of regional and rural South Australia. With this initiative, directly responsible to the Minister, South Australia has put in place a mechanism that can be used to utilise adjustment assistance in a partnership with the Commonwealth. This assistance would need to be additional to generally available measures, such as social welfare payments, job placement services and general support for retraining.

Because South Australia has less to gain from NCP than other States, especially because of the relatively more severe employment problems in regional and rural South Australia, there should be dispensation given to SA through

- a re-calculation of the competition payments
- an extension of time for implementation of changes in areas where the net (national) community benefit is small and / or possibly directed mostly outside South Australia and / or
- additional specific forms of adjustment assistance.

South Australia suggests that Recommendations 8 and 9 be amended to reflect that the purpose of the competition payments was not to fund implementation.

3. COMMENTS ON OTHER ISSUES IN DRAFT REPORT

3.1 Chapter 5: Infrastructure reforms

3.1.1 Water Reforms

Table 5.3, p. 131 - The table mis-represents South Australia's progress in four areas of water reform and should be amended as follows:

Water trading	
Environmental allocation	implementing
Water property rights separate from land	implemented
Trading in water entitlements	implemented

Institutional reform	
Performance compliance	implementing / implemented

There appear to be two issues that are not addressed in relation to water reform, which the Commission may wish to consider.

The first is the need for the provision of consistent information to participants in the water market and the role such information plays in ensuring efficient trade and maximising economic and environmental gains.

The second is to note the significant private benefit accruing to those who possess water rights as a result of the separation of the water right from the land asset. The reform process ensures that water allocations become a priced and tradeable asset, the value of which irrigators may not have been able to maximise in the past. For instance, any unused allocation can now be traded on a permanent or temporary basis.

3.1.2 Road Transport Reforms

In the area of road transport reform, the draft report has relied heavily on anecdotal evidence. The argument in this section of the report is not as tight as it could be.

The draft report quotes the NCC's 1996-97 Annual report which states that the NCP Implementation Agreement for road transport reform requires "the timely development and implementation of heavy vehicle regulation" (p. 145). The draft report makes some wide-ranging statements about the benefits of these reforms for country Australia (see pp 143-144):

> "Residents of rural communities ... depend on road transport for access to health services provided by regional hospitals, face-to-face financial services and the like, and to travel to see friends and participate in entertainment. More generally, road transport serves the important social function of bringing isolated communities closer together. Reforms to increase the efficiency of the sector therefore have much to offer country Australia."

It is difficult to see how road transport reforms, such as uniform heavy vehicle charges, aimed at regulating commercial motor vehicles, will help people living in the country to "travel to see friends and participate in entertainment" or any of the other 'benefits' listed above.

The obvious benefit to rural and regional Australia lies in the continuing reduction of the cost of transporting goods into or out of the location. Such cost savings in the transportation of goods will increase the scope for competitive pricing that regional exporters can offer buyers of agricultural and mining products. Conversely, the lower cost of transporting goods into remote regions should (eventually) result in price reductions at the consumer level.

It seems that the scope to reduce the costs associated with transporting goods by rail has been largely overlooked, despite the fact that the regulatory regime for railroads is even

less well developed and more variable across and within jurisdictions than commercial road transport.

While the environmental and safety impacts of the increased use of roads by heavier commercial vehicles are discussed, the reduction of the diesel fuel excise offered to heavy vehicles in the tax package is seen as the major contributor to the reduction of transport costs in the country. This is despite the fact that the proposed reduction would have placed transportation by rail at a further competitive disadvantage and ignored the obvious benefits of rail transport over road transport (eg, reduced wear and tear on road infrastructure caused by heavy vehicles, leading to lower maintenance costs for road authorities; improved safety outcomes for motorists; appeases community concern about the increasing number and size of heavy vehicles on the roads). However, following alteration of the tax reform package negotiated between the Commonwealth Government and the Democrats, the impact of the revised diesel fuel rebate needs to be re-analysed.

Reforming road transport regulation and charges across jurisdictions is of prime importance to the competitive pricing of exported and imported goods, an achievable benefit of NCP for rural and regional Australian residents and industries, but so too is the need for similar reform of other modes of transport such as rail.

3.2 Chapter 8: Competitive neutrality and local government

3.2.1 The draft report states (p. 206) that "South Australia [has] ... not progressed as far as other States"

Progress in implementing NCP in the local government sector in South Australia has been appropriate to the scale of business activities conducted by local governments. Business activities conducted by SA local governments are limited in both scope and nature. The economic benefits to flow from the implementation of NCP reforms are likely to be insignificant in terms of the national economy. The only delay that occurred was a three month delay for the initial reporting cycle because of the amalgamation process being undertaken by a significant number of councils.

Despite the limited benefits expected, the local government sector has undertaken its role seriously. This is evidenced by:

- Prompt involvement in the development of a Clause 7 Statement;
- The development and dissemination of suitable advisory material to councils to assist them in implementing NCP;
- Raising the issue at seminars and meetings of regional and state-wide local government bodies;
- The development and delivery of training courses specifically dealing with National Competition Policy and its various issues;
- The appointment of a consultant in August 1997, as a resource to all councils in the state to provide assistance in implementation issues (this appointment is still current and likely to be continued until at least December 1999);
- The prompt review of by-laws by councils to remove anti-competitive measures wherever possible;
- The identification of significant business activities within agreed timeframes;

- The application of competitive neutrality principles to significant business activities;
- The 100% response by councils in reporting progress in meeting the timetable of the Clause 7 statement over the last two financial years.

In addition, there is evidence that councils have understood the intent of the reforms and are making a genuine effort to implement the intent rather than the letter of the agreement, in ensuring that council business activities, even where they are not significant, do not compete unfairly with the private sector.

3.2.2 The draft report states (p. 208) that "Chief among the concerns expressed to the Commission has been that many local government activities should not be considered business activities and, thus, should not be subject to CN policy."

The revised Clause 7 Policy Statement will provide more guidance on what is and is not a "business activity" including an explicit exception that "where the achievement of community benefits is the main priority of the activity", it is not a "business" activity.

3.2.3 The draft report states (p. 209) that "Some participants were critical of the apparent lack of autonomy afforded local government in determining whether any of their business activities were significant for the purposes of CN policy."

It is considered that Local Governments do enjoy considerable autonomy in SA. Local Governments in SA were responsible for determining which activities were significant business activities, and the CN principles appropriate to apply. Local Governments also have the opportunity to establish their own complaints mechanism, or use a panel established by the Local Government Association for the handling of CN complaints. All CN complaints received concerning a local government activity are referred to the local government/s involved for initial investigation, report and possible resolution. Only where the complainant is not satisfied with the outcome of this process will the State Government complaint handling process be relevant.

3.2.4 The draft report states (p. 210) that "Some of the criticisms of participants appear to arise from a simple lack of awareness of the scope and flexibility of the public interest provisions of the reforms"

The need for more awareness and guidance regarding the public interest provisions is recognised. The revised Clause 7 Statement and guidelines for Local Government which are currently being drafted aim to provide this, but see earlier comments on Recommendation 2.

3.2.5 The draft report states (p. 218) that "[In] South Australia ... at the local government level, there have been only limited effects to date from implementing [competitive neutrality]".

As the report recognises, this is because of the low level of local government business activity. However, there has been a cultural change, influenced by NCP which has reinforced the need for transparency, full cost accounting and separation of commercial and non-commercial activities.

3.2.6 Page 206 Box 8.1 insert the following about SA

"For purposes of prioritising implementation, SA identifies Category 1 business activities as greater than or equal to $2m in revenue or $20m in assets; and Category 2 as any other significant business activities."

3.3 Chapter 13: Measures to promote and develop country Australia, pp 311-315 Horizontal Fiscal Equity

The draft report refers to the principle of horizontal fiscal equity as being an important element of the Australian federal system. South Australia believes it to be crucial to the development of those States with relatively low revenue capacity.

The principle of horizontal fiscal equalisation (HFE) is based on Australia's commitment to ensuring that each State has the capacity to provide public services at a similar standard and level of efficiency to the other States for a comparable revenue-raising effort.

History and international practice both support implementation of some form of fiscal equalisation. Equalisation is practised explicitly in most federations and implicitly takes place in nations with unitary systems of government. Equalisation payments cannot be viewed as 'subsidies'; they are an integral part of the distribution of resources inherent in the federal system.

In the absence of equalisation, those States which, through no fault of their own, face high costs or have a low capacity to raise revenues would be unable to provide their communities with the level of service offered elsewhere in Australia. Without equalisation transfers, these States would have to impose higher rates of taxation in order to fund an average level of services or else settle for fewer or lower standard services. Equalisation is thus an important element in ensuring equity for States, regardless of their demographic, economic or geographic circumstances. It would also be inefficient nationally if resources were attracted to regions with (say) a low payroll tax rate merely because of the concentration of other revenue sources such as mining developments or financial market activity in those regions.

It is fact that some States are disadvantaged in terms of their revenue raising capacities (for example through a lower level of economic activity) or expenditure requirements (for example an older population requiring more health services). Such disadvantages exist regardless of State Government policy.

A significant aspect of the intergovernmental agreement for the introduction of national tax reform is the explicit stipulation that HFE will be used to distribute the goods and services tax revenues among the States. South Australia regards this as a considerable advance on the current situation where the use of equalisation for financial assistance grants has no legislative or formal basis, and where periodic attempts have been made by the larger States to overturn its use.

The draft report notes that, in addition to the application of HFE to grants paid to States, the Commonwealth Government requires States to establish a local government grants commission to allocate **funding to local government authorities** using HFE principles.

However, as pointed out at SA's meeting with the Productivity Commission on 22 June 1999, fiscal equalisation does not apply fully to the local government sector. Financial assistance grants for local government are distributed between the States on an equal per capita basis; that is, there is no equalisation at this level. It is an anomaly that equalisation is used for allocation of local government grants *within* States, but not *between* States.

The consequence is that equalisation is applied (at least to the extent of available funding) between local government authorities in any one State, but not between authorities in different States. As a result, the standard of services provided by local government authorities will be lower in some States and / or the level of local government rates will be higher in some States in order to fund the average level of services.

The last time the Commonwealth Grants Commission examined this issue (in 1991), it found that the application of HFE to the interstate distribution of local government Financial Assistance Grants would be significantly different to the present equal per capita distribution. SA notes that this conclusion was reached by the Commission's examination of total State funding for local government, thus avoiding the very detailed and costly alternative of assessing the needs of individual local government authorities.

The continuing anomaly of a lack of equalisation for local government funding is, SA believes, an unsatisfactory position which needs to be addressed at a national level. It has significant consequences for regional development, particularly in those States with lower capacities to raise local government rates revenues and those facing expenditure disadvantages in the major local government activity of roads construction and maintenance.

The Commonwealth's *Local Government (Financial Assistance) Act 1995* includes provision for a review of local government funding arrangements before June 2001 – the opportunity thus provided should be used to review this important aspect of equity for regional Australia.

South Australia suggests that the final report should recommend that the anomaly with respect to HFE be addressed at a national level.

3.4 Chapter 13: Measures to promote and develop country Australia p. 315

In relation to the provision of the telecommunications USO to be adopted as part of the sale of the second tranche of Telstra, SA has advised the Department of Communications, Information Technology and the Arts that:

The SA Government supports the principle of tendering of the telecommunications USO. This has, subject to a suitable policy and procedural framework, the potential to:

- Reduce overall USO costs:

- Encourage telecommunications service competition in regional areas; and
- Bring service benefits and cost reductions to regional areas

South Australia's regional areas are large but relatively sparsely populated. It is difficult to see how the residents of these areas will receive the much needed benefits of improved telecommunications services and reduced costs, that should result from competition, without some form of Government intervention or incentive.

However the concept of USO tendering is complex. If implemented it should:

- Ensure the deliver of a USO service or better to those it is intended to directly benefit;
- Produce an overall net reduction in cost;
- Facilitate competition in regional areas; and
- Support and encourage longer-term regional telecommunications service improvements both within the defined USO and within general, commercial range of services offered.

- The USO tender policy and process should not:
- Be so complex as to be disruptive, difficult to manage and involve significant overhead costs;
- Reduce the current level of service provided to any telecommunications users in the regions:
- Have transition or exit arrangements that cause any user to be temporarily without service or otherwise disadvantaged; and
- Simply swap one monopoly for another.

In developing and refining the telecommunications USO tendering policy and procedures it is requested that models be included that are based on regional areas with demographics and socioeconomic profiles similar to South Australia. This will be required to ensure that the intended benefits of the policy are realised in these situations both in South Australia and elsewhere.

3.5 Appendix C

2.6

p. 410 Amend first paragraph to read

"A review of the Wine Grapes Industry Act 1991 is underway. PIRSA engaged KPMG Management Consulting Limited to conduct a preliminary analysis, as part of a concurrent review of aspects of the NSW *Marketing of Primary Products Act 1983* and the Victorian *Agricultural Industry Development Act 1990.*"

In Table C.7 p. 410 status of *Wheat Marketing Act 1989* is "national review likely".

In Table 7.1 p. 175 the Metropolitan Milk Board has been replaced by the Dairy Authority of SA.

2.3 RECOMMENDATION 4

In the case of reviews of anti-competitive legislation which may have significant impacts extending across jurisdictions, the benefits and costs should be weighed in terms of the interests of Australians as a whole.

In arguing for a more flexible approach to implementation, the original South Australian submission (see *4.1.3 Differences between and within jurisdictions*) used nationally uniform vehicle mass and dimensional limits as an example. In this instance, SA is taking a stance which supports SA interests but which can also be justified by national interest considerations. Despite this, the draft report implicitly criticises SA by supporting the contrary Victorian position.

SA's original submission stated

> "As presently drafted, there are requirements under national road transport reforms to adopt upper limits on vehicle mass and dimensions, even though local roads and bridges may be capable of taking vehicles with higher or larger loads, thus increasing transport efficiency. For example, Victoria has objected to South Australia's permission for the transport of citrus fruits to the Port in larger containers, even though this transport is critical to the international competitiveness of produce which is vital to the viability of the Riverland regions of the State. This example illustrates the risk of national uniformity imposing inappropriate standards, based on the operating conditions in more populous States and regions, to the disadvantage of rural and regional Australia. States should be allowed to tailor regulatory requirements to suit the local conditions in their various regions, rather than slavishly adhering to national uniformity."

~~However, t~~The Productivity Commission appears to have misunderstood this argument, instead supporting ~~chose instead to give prominence to~~ the Victorian point of view (see p. 146):

> "A transport operator in Mildura claimed that, because only Victoria has enforced the uniform mass limits strictly, his competitiveness had declined compared with operators from other States where more latitude is given."

Victoria has chosen to impose a rigid upper limit on the mass and dimensions of heavy vehicles in all circumstances. By contrast, South Australia's approach is more in keeping with the guiding principle in clause 5 of the Competition Principles Agreement This State has no upper limit; individual permits may be given for any overmass or overdimension vehicles to operate on roads, where the costs of doing so for the community as a whole do not exceed the benefits. It is the blanket restriction on competition imposed by the Victorian regulatory approach which places its operators at a competitive disadvantage relative to South Australian operators, rather than any inappropriate action on the part of South Australia.

South Australia reiterates its view that the setting of upper mass limits should be done in relation to the design and condition of the roads and bridges and the nature of the traffic on the particular route in question. If some South Australian roads can appropriately accept higher mass limits, with the productivity benefits this implies, then artificially imposed

uniform mass limits are inappropriate. Where there are no overriding safety or infrastructure reasons to prevent further local increases in mass limits, it would be highly unlikely that the South Australian Parliament or Minister for Transport and Urban Planning would not continue to support such increases.

The force of this argument has now been accepted by the National Road Transport Commission and Transport Agency Chief Executives. The purported upper limit for permits was included in national road transport reforms without the preparation of a Regulation Impact Statement covering this issue. This restriction is now to be reviewed by the NRTC, at the instigation of South Australia.

For Victoria to argue, and the Productivity Commission to support, a position which seeks to protect Victorian primary producers and transport operators, to the detriment of more efficient production and transportation in South Australia, is ~~contrary to the intent of NCP and does not advance the interests of "Australians as a whole".~~illogical and unjust. This is especially so when the draft report identifies that the full implementation of road transport reforms "would increase GDP by more than $1.2 billion a year, with around two-thirds of this gain arising from the Mass Limits Review proposals" (p. 147). South Australia fully recognises the importance of road transport reform, and has been a leader in the introduction of many significant productivity reforms. For example, South Australia was the first jurisdiction to adopt the higher mass limits on gazetted routes, in accordance with a proposal which Transport Ministers have had under consideration for some time. This State adopted the higher mass limits, (which operate as-of-right, ie with no obligation to apply for a permit) on appropriate routes on 1 January 1999, 6 months in advance of the roll out of this reform in Victoria. Rather than being criticised for failing to follow the restrictive policies of its neighbours, South Australia should be congratulated for its progressive and productive approach to road transport reform.

South Australia suggests that the final report should ~~consider~~ be amended to reflect that it is the South Australian practice in relation to road transport reform which accords with Recommendation 4, not that of Victoria in this specific instance.~~both the Victorian and South Australian positions on road transport reforms in light of Recommendation 4.~~