

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

Submission by:

THE DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

The Foreign Affairs and Trade White Paper states: "The economic well-being of Australia - the jobs and standards of living of ordinary Australians, and the social cohesion they engender - is fundamental to Australia's foreign and trade policy"¹. There is no ambiguity that this goal applies to all Australians - in metropolitan, rural and regional Australia.

Introduction

1. Competition policy reforms have been an important part of Australia's microeconomic reform agenda. While the combined economic impact of microeconomic reforms has been quite far reaching, effects on specific sectors of the economy have varied. The effect on sectors such as telecommunications or public utilities, which are no longer subject to exclusive monopoly suppliers, have been considerably easier to quantify than in broader sectors, particularly those where a range of microeconomic reforms have had a combined effect. In particular, the aggregated and multifaceted characteristics of rural and regional Australia makes it difficult to assess precisely the impact of competition policy reforms. In this submission, National Competition Policy (NCP) is treated as a continuum of the microeconomic reforms aimed at increasing competition which began in the 1980s. Within this broader framework, the benefits flowing from increased competition are undeniable, including in rural and regional Australia.

2. This submission considers the impact of NCP on rural and regional Australia across the areas of responsibility of the Foreign Affairs and Trade portfolio. Issues addressed in this submission are:

- the effect of competition policy on Australia's trade competitiveness and trade performance and the flow-on benefits to Australia's rural and regional communities
- the new opportunities presented by globalisation
- the benefits of trade liberalisation to Australia's rural and regional communities
- foreign investment and competition policy
- the impact of NCP on the development of electronic commerce
- application of NCP to Export Finance and Insurance Corporation (EFIC).

¹ *In the National Interest: Australia's Foreign and Trade Policy White Paper*, Commonwealth of Australia, 1997, p3

Trade Competitiveness

3. The increase in competition following the reduction in industry tariffs and other reforms, including competition policy reforms, have had a significant and positive effect on Australia's trade performance. By removing and guarding against competition-distorting market structures, economic resources are now allocated more efficiently. This has led to the development of a range of new internationally-competitive products and services which can be sold in markets worldwide, as well as in Australia.

4. An analysis of export performance is fundamental to assessing the economic development of rural and regional Australia. As Australian businesses become more engaged in world markets, exports are becoming increasingly important in providing jobs and delivering improvements in our standards of living. Indeed, exporters are among Australia's strongest businesses. They are more productive per employee than those businesses that do not export, largely reflecting their exposure to international competition. They also pay higher wages and the flow-on benefits of this are clearly visible in communities which host export businesses. (See attached: Trade Liberalisation: Opportunities for Australia, DFAT 1997.)

5. The establishment of a competitive market structure ensures that Australian exporters have access to competitively priced production inputs, both manufactures and services. This ensures that Australian exporters are paying competitive prices for basic inputs which enables them to effectively compete in world markets. This is relevant to the provision of intermediate inputs as well as basic services to rural and regional Australia such as transport, energy and telecommunications.

6. Economic reforms since the mid 1980s, including the NCP, have helped to increase the competitiveness of Australia's predominantly rural-based primary-industry sector. The cost of basic services such as transport, telecommunications and public utilities, which represent a large part of costs of rural businesses, have been reduced substantially. According to the National Competition Council, increased competition over the past few years has reduced prices by 20 per cent for grain haulage, 25-30 per cent for electricity (in some States), 40 per cent for container rail freight, and up to 50 per cent for gas.

7. Competition policy reforms have had a positive effect on the development of more market-oriented marketing arrangements for agricultural commodities. Traditional statutory marketing authorities which bought commodities from producers and re-sold them to final consumers are being progressively phased-out. Their transformation over the past several years has improved the communication between markets and the producers and established a more direct relationship between price and quality. Examples of this include deregulation of milk prices beyond the farm gate, deregulation of domestic marketing arrangements for wheat, and deregulation of egg marketing - most of which have delivered lower prices to consumers and producers further up in the production process. Along with other government microeconomic reforms, these reforms have contributed to improvement in productivity and competitiveness of these sectors. They have stimulated innovation and development, for example in the wheat industry, where wheats for noodle, pasta, biscuits and industrial uses have been developed. They have also led to export orientation, for example in the dairy industry, where high value-added cheeses have become point-products leading Australia's dairy exports into new markets.

8. That said, there is a continuing need to develop and apply competition policy flexibly and pragmatically so that Australia's interests on the "un-level playing field" of the international trade arena can be advanced as effectively as possible.

9. Australia's single-desk" selling arrangements which facilitate the marketing of Australian commodities overseas, including wheat, sugar and rice continue to be pragmatic, sensible

arrangements that are clearly in the national interest. Some of these arrangements have been retained following extensive reviews because they were shown to allow Australian producers to maximise returns in overseas markets without adversely affecting Australia's domestic consumers. Furthermore, it has been recognised that many Australian agricultural commodity producers sell into international markets which are often distorted by government intervention and in which the size of individual buyers can influence market outcomes.

10. The Uruguay Round outcomes have opened the way for international markets in agricultural commodities to operate more competitively and efficiently. These trends could well be reinforced by negotiations in the World Trade Organization in coming years. In these changing circumstances, agricultural marketing organisations must be encouraged to develop in a way that increases the scope for individual producers to develop new profitable markets, including by taking advantage of niche marketing opportunities and increasing their focus on product development and innovation. The current approach of seeking greater integration of specialist processing and marketing of farm products with on-farm production is a step in the right direction.

Trade performance

11. Increased domestic competition has had a positive effect also on the relative competitiveness of Australian industries. While primary-sector producers have benefited, they have not been the only or the largest beneficiaries. The competitiveness of Australia's services and manufacturing industries has increased remarkably. The relative change in the international competitiveness of Australia's industries, as well as other factors such as the degree of trade liberalisation and international market demand, have led to a significant change in the composition of Australia's trade.

12. Primary products' share of total merchandise exports decreased from 69.3 per cent in 1987 to 58.9 per cent in 1997. Over the same decade, exports of manufactured products increased from 23.1 per cent to 33.1 per cent. These changes reflect the increased competitiveness of Australia's manufacturing sector following the reduction in the levels of industry protection and increased domestic competition, including as a result of NCP. It is important to note that rural production has not fallen and exports of rural products have continued to increase in absolute terms. The trend growth of primary product exports between 1987 and 1997 was 5.8 per cent. Some high value-added rural exports such as processed food grew by 8.4 per cent. Over the same period, exports of manufactured products grew by 12.4 per cent - more than double the rate of primary products. Simply transformed manufactures grew by 7.0 per cent and elaborately transformed manufactures grew by 16.2 per cent.

13. In the services sector, the benefits of increased competition are even more visible. Increased competition in the communications sector has led to the development of new export products in sectors such as finance, insurance, information technology and professional services. Australia's service exports, including tourism and education - both of which have become important to regional Australia, have benefited significantly from the reduced costs. In the decade since 1986-87, Australia's trade in services has increased by over 9 per cent per annum. The relative significance of services exports to Australia's total trade has also increased during the decade. In 1986-87 services accounted for 18 per cent of total trade in goods and services, by 1996-97 this proportion had increased to 23 per cent. The importance of these industries to Australia's trade is likely to increase further in the coming years.

14. The change in the composition and trend growth of exports since the introduction of NCP is difficult to isolate from the effects of other reform policies. The effect of the East Asian economic crisis on Australia's export performance over the past year complicates the picture further.

Nevertheless, the trends observed over the past decade have been broadly maintained since the introduction of NCP in 1995.

Globalisation

15. The process of globalisation - the increasing integration of world markets for goods, services and capital - has accelerated over the past decade and has had a profound impact on the Australian economy, including on rural and regional Australia. It has been driven by advances in transport, communications and computing technologies; the lowering of trade barriers worldwide; and the freeing up and deregulation of capital markets in many countries. These factors have contributed to facilitate the movement of goods, information and capital around the world.

16. Globalisation is a powerful force for increasing living standards worldwide, especially for countries with open trading and financial systems and efficient and competitive business structures. By opening their markets, and encouraging trade and investment, they are well placed to harness new technologies and business opportunities, and make the most of their people and resource endowments generally.

17. Globalisation rolls on regardless of Australia's policy choices. A middle-size country like Australia, which must trade vigorously to make its way in the world, cannot resist the forces of globalisation without dropping its living standards. Australia's domestic economy must adjust to the realities of global production and capital flows so that it can take advantage of the opportunities presented by globalisation.

18. Australian businesses are increasingly required to meet internationally based standards or "benchmarks" to be competitive, whether they are exporters themselves or are associated with exporters' supply chains in any way. Furthermore, businesses not producing for international markets are affected by globalisation to the extent they and their competitors can choose inputs and capital goods produced in world markets. The competition policy reforms have contributed to removing market-distorting inefficiencies, provided clear incentives for higher productivity, and stimulated more businesses to look beyond Australia's domestic market to sell their products and purchase their inputs. This has been invaluable in preparing Australian companies to take advantage of the opportunities provided by globalisation.

19. Globalisation has influenced market structure developments in rural and regional Australia and has led to the development of business behaviour which is oriented to world markets, rather than a particular domestic market. This is clearly illustrated by the change to Australia's trade performance over the past decade.

Benefits Of Trade Liberalisation

20. Developments in trade liberalisation have been prominent in the policy environment which has coincided with the development and implementation of NCP. Australia has been a major player in the World Trade Organisation (WTO), and through its leadership of the Cairns Group, a group of fair-trading agricultural exporters, played an influential role in the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT). Australia's strong commitment to see a conclusion to the Uruguay Round reflected the fact that the agri-food industry is among the largest sectors of the Australian economy and is one of its biggest export earners. Over 70 per cent of Australia's farm production is exported. International trade liberalisation has become critical to the economic well-being of Australia's rural and food sector and the wider economy.

21. It has been estimated that implementation of the Uruguay Round Agreement on Agriculture alone could increase the value of Australia's rural exports by as much as \$1 billion per year. The benefits are spread throughout the agriculture and food sector and include beef exports rising by an estimated \$300 million a year, wheat by \$320 million, dairy by \$210 million, coarse grains by \$50 million, rice by \$30 million and sugar by \$10 million. Gains since the Round in removing or reducing bilateral market access barriers, including on some tariff, tariff quota and quarantine issues, and through WTO accession negotiations, have reaped further benefits estimated to be worth collectively hundreds of millions of dollars in agricultural and food export opportunities.

22. It is clear that rural and regional Australia has been a major beneficiary of Australia's efforts at increased trade liberalisation through the creation of jobs and wealth. Importantly, the benefits of trade liberalisation go beyond the producers of bulk agricultural commodities. The most successful regional and rural areas have been those which have broadened their participation in export markets, including through more processing ("value adding") of commodities and selling into specialised niche markets. There are many examples of a successful transition to increased export production in rural and regional Australia following a reduction in the levels of protection and introduction of competition policy reforms. The Darling Downs, exporting horticulture, meat, and education services, and the Murray Valley and Riverina, exporting dairy products, rice and manufactures, are examples.

23. The wealth created by the improved productivity of Australia's primary producers in response to international competition has strong flow-on effect in supporting and creating jobs in the region. In the case of the dairy industry in the Goulburn-Ovens-Murray region, the unemployment rate in that region has fallen from around 13 per cent in 1992 to around 7 per cent in 1998.

24. The prospects for further agricultural trade liberalisation are promising because of the solid groundwork already achieved in the Uruguay Round. The Uruguay Round agreement on Agriculture recognises the long term objective of substantial reduction in agricultural support and protection. It mandates a further set of multilateral agricultural negotiations to begin before the end of 1999. These negotiations will build on the Uruguay Round agreement to deliver further farm trade reform in the market access, export subsidies and domestic support areas.

Foreign Investment

25. Foreign investment has played an important part in Australia's economic development and will continue to do so in the future. Australia has traditionally drawn on foreign sources of finance to fund higher levels of investment than domestic savings alone would have been able to provide. Foreign investment has contributed to the development of world class industries in Australia - including in rural and remote regions, where it has directly contributed to mining and pastoral development.

26. Competition policy makes an important contribution to Australia's foreign investment strategy. A competitive economic structure in Australia is increasing the appeal of Australia to foreign companies considering using it as a base for their manufacturing operations for supplying the domestic market and exporting to the region and beyond. As countries all over the world compete for foreign investment, there is growing recognition that the most effective way of attracting foreign investment is to focus on making the business environment more attractive.

27. Rural and regional Australia has benefited from Australia's success at attracting foreign investment. Around half of all investment in the mining industry has been from foreign sources. Foreign investment in the food processing sector, which has been estimated to be 5 per cent of all foreign investment, is an example of the benefits of foreign investment in Australia's agriculture.

Half of Australia's agricultural exports are now made up of input-intensive agriculture such as horticultural and highly processed food products. Success in this highly value-added activity often requires large investments in highly integrated production and marketing systems in Australia and overseas. Foreign investors can provide access to these systems overseas and help to build exports in this important sector.

28. Continued and improving access to efficient infrastructure and services, including rail and road transport, sufficient and secure energy supplies and reliable local government services in rural and regional areas, will be needed to continue to attract foreign investors.

Electronic Commerce

29. Electronic commerce is a new area of trade policy which has the potential to positively impact on the development of Australia's rural and regional communities. The NCP has had a direct effect on increasing competition in the telecommunications sector which has led to the development of innovative approaches to service delivery and new technologies such as electronic commerce on the internet.

30. Slaying the tyranny of distance through increased use of electronic commerce offers significant opportunities to small and medium enterprises located in rural and regional Australia to become involved in export activities, particularly in handling the sale and just-in-time distribution of agricultural products and livestock to consumers overseas. The internet is a powerful tool for increasing the market outreach of companies. Internet-based electronic commerce lowers costs by minimising a physical presence in overseas markets. It is ideal for selling goods like flowers, foodstuffs and clothing which require no after-sale service and can reach consumers through international airmail or other delivery services. The goods can be easily produced in and despatched from areas other than metropolitan Australia.

31. Electronic commerce is also a mechanism for improving efficiency within businesses and across supply chains. This is probably its most important application and links directly to lifting the competitiveness of businesses in increasingly competitive national and global markets.

32. DFAT's research in this area (see attached Putting Australia on the New Silk Road: The Role of Trade Policy in Advancing Electronic Commerce (1997)) has revealed many examples of small companies in regional, as well as isolated parts of Australia, using internet-based commerce to reach customers all over the world. The Department has been active in designing a strategy for developing Australia's electronic commerce which includes an emphasis on using the internet to improve trading opportunities for rural and regional Australia.

Application of NCP to Export Credit and Insurance Corporation (EFIC)

33. The Government's approach to the application of NCP to the Export Finance and Insurance Corporation (EFIC) has reflected EFIC's focus on providing to exporters finance services which address the market gap. EFIC's operations are primarily directed to those countries, sectors and market circumstances where the private market is unable or unwilling to provide export insurance and other services.

34. As Australia's official Export Credit Agency, EFIC's competition is its overseas counterparts, the export credit agencies of other countries. Working with exporters and their banks, EFIC provides a range of short-term credit insurance and guarantee services to Australian exporters as well as medium to long-term finance, guarantee and political risk insurance services. Many of the services provided are regarded as Community Service Obligations (CSOs).

35. In 1997-98, EFIC supported \$7.5 billion of exports - around 70 per cent were rural-based agri-food and mining products. In 1998-99, EFIC will provide through its National Interest Account export credit insurance cover for exports of up to 4 million tonnes of Australian wheat to markets where commercial cover is not available. Earlier in the year, EFIC worked with banks in Australia to keep trade flowing to Korea when exports to this market were threatened because of importers' difficulties in obtaining commercial trade credit. Around \$1 billion of exports were supported, drawing in part on a \$500m facility the Government put in place to augment EFIC's capacity.

36. Following a review of EFIC's operations in 1997, the Government announced that EFIC will remain in public ownership, retain its guarantee and continue to provide essential finance and insurance services not provided by the private sector. Within that framework, there are to be some further operational changes to take account of NCP. These measures have not yet been finalised.

37. The Government's decision to retain EFIC in public ownership reflected, in part, the situation in key Asian economies and the need to ensure a timely and effective response on behalf of Australian exporters, particularly rural exporters and small and medium enterprises.

Conclusion

38. NCP has delivered substantial benefits to rural and regional Australia by improving its export competitiveness and, consequently, its trade performance. Further improvements in Australia's trade performance will be assisted by continued reforms to achieve and maintain a more competitive domestic environment which reduces costs and prepares Australian companies for the challenges of international competition.

39. DFAT notes that the benefits of agricultural trade liberalisation have been well documented but the effect of domestic agricultural reforms, including those flowing from the application of NCP on the export performance of Australia's agricultural producers need to be quantified more. It would be particularly valuable to assess and review the contribution of agricultural marketing organisations on Australia's export performance and rural and regional development. This could point to appropriate strategies for developing such organisations to ensure they continue to benefit the national interest and key stakeholders, including agricultural producers and their communities, and domestic down-stream businesses and consumers.