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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO NATIONAL COMPETITION POLICY REFORMS

MR G. BANKS, Chairman
MR P. WEICKHARDT, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT CANBERRA ON TUESDAY, 14 DECEMBER 2004, AT 9.00 AM

Continued from 13/12/04

MR BANKS: Good morning everybody. We'll start our hearings today with the Australian Trucking Association. Welcome to the hearings. Could I ask you to give your name, please, and your position.

MR GOW: Yes. My name is Neil Gow. I'm the national manager, government relations, with the Australian Trucking Association.

MR BANKS: Thank you very much for attending the hearings. We haven't seen a written submission, so I'll leave it to you to perhaps outline the main points you want to make.

MR GOW: Thank you very much, commissioners. The Australian Trucking Association has a real interest in the work being done by the Productivity Commission in this area. We've participated in past inquiries of the commission, that being the cost recovery by government agencies inquiry done and reported on in August 2001 and the current inquiry into energy efficiency, where the ATA has also attended hearings and made a submission. This inquiry is also of real interest to us.

MR BANKS: Could you perhaps just note for the record your organisation and who it represents?

MR GOW: Certainly, yes. The Australian Trucking Association is a broad alliance of state and sector based trucking associations, of which there are eight, national trucking transport companies, who also are members of the Australian Trucking Association and the Transport Workers Union. Also our council includes two popularly elected representatives of owner-drivers and small fleet operators; small fleet being up to five trucks. All of those members participate in our general council. The charter of the Australian Trucking Association are broad policy issues which can be delivered as much as possible in a nationally consistent way to address the issues of the freight task. So that's the Australian Trucking Association. Its offices are in Canberra on National Circuit.

MR WEICKHARDT: Are any of the big players in the trucking industry not members, directly or indirectly, of your association?

MR GOW: No.

MR WEICKHARDT: So all the big guys - Toll, Linfox, et cetera - are all represented, are they?

MR GOW: That's correct. They're either members of our member associations or choose to be members of the Australian Trucking Association as well. For a company to be a member of the Australian Trucking Association, they have to be a

member of a member association as well.

MR WEICKHARDT: Thank you.

MR GOW: I'd just like to quickly outline the industry itself, because there are some 450,000 heavy vehicles in Australia; that is, over four and a half tonne GVM. That ranges from the two-axle rigid truck that does a lot of urban pick up and delivery work, heavy courier work, express work, et cetera, right through to the road trains that, of course, our outback regions are famous for around the world, and the intervening heavy rigid vehicles and trailers, articulated vehicles, the standard six-axle articulated semitrailer that people refer to and, of course, B-double trucks as well; eight or nine-axle B-double trucks.

The articulated vehicles in that total fleet comprise some 65,000 trucks in Australia, just to put a number on that. The sort of quantity of freight moved by that fleet in the year is about 1.5 billion tonnes of freight, covering some 12.5 billion kilometres a year to move that amount of freight on a road network that totals about 810,000 kilometres in Australia. That just gives some idea of the size of the fleet. We make a distinction that there are those people involved in road freight transport who carry other people's freight, and we refer to them as "the hire and reward sector". Many of the heavy trucks, though, in that number are used by businesses whose prime focus is not trucking, but it could be a sawmill, it could be a brewery or it could be a retail outlet who have a truck, and we refer to them as "the ancillary fleet".

The principal interest of the Australian Trucking Association is the hire and reward fleet, but we're also interested in developing and preserving national solutions that cover all of the heavy vehicle fleet, so we have an indirect interest in the ancillary fleet as well. In order to do that, we have close relations with other industry associations who have truck usage, whether that be the National Farmers Federation, the retailers or whatever, the mining people who have trucks, but mainly to carry their own freight.

MR BANKS: Thank you.

MR GOW: With that bit of background, of course, the long story of the development of national competition policy in Australia and the genesis of the National Road Transport Commission - now the National Transport Commission - to assist in achieving those reforms is one that's intimately linked to the history of the Australian Trucking Association, which was formed in 1989. Even though those state and smaller national bodies had existed, the ATA has existed since 1989 as a national body in order to try to work with governments to achieve important national reforms in road freight transport regulation.

The Australian Trucking Association, as I say, started its history in 1989 as the Road Transport Federation. In 1999 it adopted the name Australian Trucking Association. Since that time of forming the NRTC, the ATA has been one of the bodies consulted with on specific projects, as well as generally through their industry advisory group, as well as many working parties, et cetera, so we've been intimately involved in the NRTC process. Certainly, on pages 330 and 331, the general drift of the draft report about road transport reform and addressing competition issues we generally agree with, although we wouldn't be as sanguine about the number of COAG-endorsed projects that have been fully implemented by all jurisdictions as the draft report is. I'll come to that in a minute.

But the areas identified as needing work - uniform heavy vehicle charges, et cetera - on page 330, was a very ambitious and important list and the industry has done a lot to work with governments through these forums, organised and hosted by the NRTC, to move down that path. Given the terms of reference of the inquiry, we feel that there are still areas:

> Offering opportunities to significant gains to the Australian economy from reviewing impediments to efficiency and enhancing competition, including through a possible further legislative review and reform program.

So we feel there's some real work to be done in addressing that term of reference of the inquiry. I want to speak of some specifics now. There are about six of those that I'd like to address.

MR BANKS: Good.

MR GOW: One of the biggest tasks of the NRTC on its foundation was to develop a system of national charges for heavy vehicles. A lot of work was done in the first determination of heavy vehicle charges to set up a structure based on data to recover the attributed cost of road construction and maintenance expenditure to heavy vehicles. That was implemented, of course, from the mid-1990s. The basic structure was to total all road construction and expenditure funds in Australia, work out which of those were separable to vehicles, including heavy vehicles, and then work out that amount of the expenditure attributable to heavy vehicles using a range of mathematics and data to end up with a number which would recover the cost attributed to the smallest heavy vehicles - the two-axle rigids - from a partial payment excise on the diesel that they used and for the heavier vehicles also for an amount of registration which would become uniform around the country. To that point, there had been different registration charges in different states, creating obvious distortions and problems for business.

From the mid-1990s, we had a cost recovery system for heavy vehicles which fully recovered the cost of the attributed construction and maintenance costs of roads to heavy vehicles and, in fact, because the states wouldn't sanction a recovery from those light rigids just from their net fuel excise - they also charged a registration fee - there is, in fact, over-recovery from the total heavy vehicle fleet because of the extra registration fees that are charged for those light heavy vehicles, which are fully recovered from their net excise charge, and for the heavy vehicles, where the proportional net excise charge based on their fuel efficiency - kilometres travelled, et cetera - wasn't sufficient. A registration is charged as well, which increases with the cost of the heavy vehicle from some $400 a year for the two axles through to close to $10,000 a year for road trains.

That structure was in place and it was reviewed during the second charges determination, which was implemented in July 2000, and currently the NTC is undertaking third charges determination work with the expectation that the technical report will be issued in early 2005 and the new charges will be implemented in 2006, and that's a time frame that the ATA strongly supports. Being able to develop a uniform national heavy vehicle charging system which recovers those attributed costs has been an important achievement of the NTC, one that the ATA supports, and I'm well aware there will be ongoing debate after the third charges determination is completed as to the principles and practices that will underlie future determinations, but we feel that that system is well founded and has been well executed by the National Transport Commission.

One area where we have some dissatisfaction is in the area of the implementation of the higher mass limits review from the mid-1990s. It's fallen well short of expectation in order to deliver the increased productivity that would be possible by adding extra weight to heavy vehicles as long as they had road-friendly suspension, as long as they were in an accreditation scheme - which basically is a methodology to set up a process whereby a transport operator is obliged to calculate the mass on their truck so they stay within those limits - and, finally, stay on specified routes that are open, rather than general access, because there were concerns that the extra weight on those trucks had implications for bridge and road wear.

Higher mass limits would deliver three tonne extra payload to a six-axle artic and eight tonne to a B-double. Those are significant numbers where the payload is, for a six-axle artic, around 20 tonne. I can only say that imprecisely, because it depends on the tare of the vehicle - how light or heavily the vehicle is constructed - but you're looking at three tonne more than 20 in round figures. It's a significant productivity increase. As I say, to gain that the operator had to buy or convert their equipment to have road-friendly suspension, which is defined in government

regulation, and a compliance plate fitted, be in accreditation and, finally, the issue of access was important.

Some states, Victoria for example, have opened 95 per cent of our arterial network to higher mass limits, and so that's been a well-implemented reform in that state. South Australia is progressing well. Western Australia and the Northern Territory have also opened their network to higher mass limits. The worst-performing state in this area is New South Wales, where only the Newell Highway running south to north, north to south, is open for higher mass limits, with some restricted access for vehicles on the federal interstate registration scheme through from Mildura to Tarcutta, but not a major route, and some local arrangements. Queensland also has very restricted access to higher mass limits.

It's only on the national highway system - or, at least, when the AusLink legislation is passed, the prior national highway system - and 500 metres either side of it. So we're pleased to see in AusLink extra funds and a commitment to expand the higher mass limits network in both of those states, New South Wales and Queensland. It's a significant reform. It's unfortunate that it has not been delivered in a nationally consistent way across Australia, and there's a lot of juice can be squeezed out of that lemon yet to increase productivity for road freight transport.

There's another scheme around - another mass scheme - which the NTC is addressing at the moment, and that's where extra mass is allowed on accredited vehicles; not as much as under higher mass limits, because it's not restricted access, but it does deliver an extra tonne to a six-axle artic and two to a B-double. Although that has had national recognition - and has it at the moment - from 1 January, New South Wales has announced they will not recognise those mass management weights in their state from people running under a pilot run by VicRoads under the Victorian government since 1997. The ATA wishes to see those mass management weights - the one and two-tonne weights I've referred to - available to all operators who undertake the accreditation under the National Heavy Vehicle Accreditation Scheme and be nationally uniform and consistent, and that's a strong position of the Australian Trucking Association.

The National Transport Commission has issued a discussion paper on the matter. Submissions closed last Friday, and we would like to see their option 2, which is to have those increased mass limits available to all accredited operators around Australia in a nationally consistent way, delivered as soon as possible. It's a reform that, where one cannot access the higher mass limits, at least being able to gain one tonne on a truck, if not three, is of some benefit. Of course, our long-term aim is to see the higher mass limits network opened throughout Australia.

A third area that's important in the productivity debate at the moment, and

being explored by the National Transport Commission, is that of incremental mass charging. The safety limits of heavy vehicle construction are well above the mass limits that are set, either by statute or in the higher mass limits scheme. For example, a six-axle artic has a safety limit of 66 tonnes. The current statutory mass is 42 and a half, and higher mass limits 45 and a half, so we're not approaching the safety limits of a six-axle artic at all in those weights. If a system can be worked out to charge based on profit data and science, if you like, of the calculated extra road wear above those weights for heavy vehicles, then that increment could be charged for and then the transport industry could consider, along with their customers, whether they would take that up - whether it did deliver a real productivity benefit - because there would not only be the direct charge for that mass.

For example, a higher mass limits vehicle, if it had an extra three tonne on and went to 48 and a half, how much that would cost would be the direct charge, but there would be the administrative costs as well within businesses, and we only have some indicative figures from the NTC at this stage. But their indicative figures do say that the productivity benefit would be greater for articulated trucks than the incremental mass charge and for heavy rigid vehicles it would only come in after a reasonable amount of weight has been added to the truck. It has a real benefit for the articulated fleet, which of course carries the majority of the freight in the long-distance role.

The ATA's position on incremental charging is one based on principle at this stage, but we do support the concept that extra mass - but within the safety limits of vehicles - should be available to transport operators provided a charge is worked out based on a transparent methodology and on verified data, but that is an area that's open for discussion as part of the third charges determination and one we hope will have a productive outcome for the road transport industry. It's an initiative from the NTC that we certainly, in general terms, strongly support.

The fifth area is quite a technical one, but I would still like to mention it because, although the mass area is one that can deliver productivity benefits, the heavy vehicle fleet is also subject to other regulation for safety and environmental reasons. We don't fundamentally disagree, of course, with safety and environmental regulation. For example, we will be obliged in all new trucks to fit engines that meet the higher or tighter emission standards of Euro4 from the beginning of 2007, but there is a payload problem with these engines. They will require either heavier engines or tanks of reagent to act as a catalyst on the exhaust fumes to reduce their emissions to the regulated level. That payload is around 3 to 5 hundred kilos, depending on how much reagent you have to carry.

We have sought that the states reconsider their current restrictions on the steer axle mass limits of trucks to increase it to six and a half tonne, from the current six

tonne, so that there will be no payload loss when this extra technology is fitted to trucks to meet the new environmental requirements for the Euro4 standard, which is regulated under Australian Design Rule 80/01. That would be a reform which we would hope would be delivered in a nationally consistent way. Obviously, if there are issues at state borders between some recognising six and a half tonne and some staying with six, it would mean that the newer trucks just wouldn't be able to travel across borders, which is a totally unproductive situation. That's another issue, and this issue was addressed by the Commonwealth government in their announcement about ADR80/01 on 12 August, so leadership is being shown by the Commonwealth on the matter, and we hope that issue is addressed in a nationally uniform way in the near future.

Another example of environmental regulation that impacts on productivity is the mandatory requirements in New South Wales and Victoria for heavy vehicles to have vertical exhausts. There's no such requirement in Europe, so not only do imported trucks have to have their underslung exhausts cut off them, thrown away and refitted to become vertical because - I'm not a techo - but there is different plumbing involved and different mufflers to do that, which can add an extra $3000 to the cost of a big truck, and certainly 500 or so to a rigid, to satisfy a requirement that is based in state legislation in New South Wales and Victoria. Although their regulations do say that requirement will lapse when the Euro4 engines come in in 2007, a main reason for coming to that conclusion was that the fuel standards for diesel in Australia would be tightened up by that time and the production would become predominantly the ultra low sulphur diesel standard.

That standard is being met by refineries in all Australian states where there are refineries, and they're supplying the states where there aren't refineries, ie Tasmania and South Australia. Ultra low sulphur diesel is available in the market well in advance of its mandatory date of 1 January 2006. A parliamentary inquiry in New South Wales in 2002 found that that regulation for vertical exhaust should be relaxed when there was a reasonable supply of ultra low sulphur diesel, because the fuel delivers a proven environmental benefit. That's another area of transport regulation which we would like to see resolved promptly, now that - since last month - the refinery in Victoria is producing the ultra low sulphur diesel product which has no more than 50 parts per million of sulphur in it.

So there's an area there that's restricting productivity, adding to the cost of vehicles because, given that Victoria and New South Wales are the major market for new and used trucks, those state regulations become a de facto national standard. Even if you're buying and registering a truck in Queensland or Western Australia or South Australia, you would still have it fitted with a vertical exhaust, because otherwise that would have to be done when it's sold on into its second or third life, so that does impact on productivity. It shortens the tray area of trucks, because of the

extra plumbing behind the cabs, and adds to the cost, as I say, of fitment as well, and is something that's no longer relevant, given the engine standards that we have and the clean fuel standards that are implemented under the Commonwealth Fuel Standards Act.

The last issue I wish to mention is that of discussion about the overall length of B-doubles. There is almost national consistency on that matter, where all states other than Western Australia have a 25-metre overall length, although Queensland provides a 5 per cent administrative tolerance in their implementation, which in fact allows B-doubles to run in Queensland at 25 and a half metres.

The ATA has worked with the National Transport Commission to increase the overall length to 26 metres. It doesn't sound much, and in many ways it's not. What it does offer, though, is flexibility within a fleet when often different prime movers and trailers are coupled together in an operation. It's not always a dedicated unit. You can find that, because on one truck a turntable may be further forward or further back, if only by half a metre, when coupled to trailers in another fleet, suddenly the combination becomes 25 and a half or 25.3 metres, which is illegal. In terms of productivity, having to try to restrict B-double activities to dedicated units or all units that fit in when there's a mixture of cab-over and bonneted trucks in the fleet, is just a nonsense, and we suggested that by going to 26 metres, but agreeing to a fixed distance from the kingpin to the rear of the second trailer of 20.6 metres, would ensure - you couldn't put that extra distance into the trailer, so it's not a productivity issue in the direct sense of extra mass or volume on the trailer. It is a productivity issue in the sense of flexibility within a fleet, whilst still maintaining the safety standards.

That's another issue being discussed at the moment by the National Transport Commission with the states; a very current issue and one that we've supported the National Transport Commission to try to get a national outcome of 26 metres for B-doubles throughout Australia.

I've tried to highlight many of the areas that we consider are ongoing and important to be addressed in the national road transport reform area. We support the national heavy vehicle charging system and look forward to that being completed on time in its third determination by 2006 and also continuing to work with the NTC in the future on future programs for road transport reform.

MR BANKS: Thanks very much. I guess we've argued in our report that it's important that we achieve neutrality across the modes of freight transport and there has been quite a debate, I guess, over time about the relative advantages of rail versus road. Indeed, we've had coastal shipping brought into the equation as well. In broad terms, do you see that as a desirable objective that, in a sense, each transport mode

would compete on its inherent sort of efficiency merits, rather than on the basis of perhaps differential investment or pricing or regulatory arrangements, just as a general proposition?

MR GOW: As a general proposition, it's attractive, but the reality is that the modes are very different; the infrastructure ownership is different; the number of players is different. When one discusses neutrality, or competitive neutrality. and one looks at the amount of support that governments provide to each of those transport modes, particularly with the expenditure of capital, it raises the question of should the same system of cost recovery apply, if you like, to that capital expenditure.

The road network, apart from some small areas of tollways where there are private arrangements with governments, is fundamentally a government resource in Australia and, of course, all the state governments are our principal road owners and managers. There is a system in place to say, "This much money is being spent on those roads and, given that there are some 10 million cars in Australia and some less than half a million heavy vehicles, part of that road expenditure is attributable to heavy vehicles." I don't know whether you can apply those same principals exactly to rail - it is a different ownership structure - and then there are questions of recovering that cost but, in general, we believe that the same principle should be applied where governments expend money on rail infrastructure as they do on road infrastructure. If that's competitive neutrality, we would agree with that.

MR BANKS: Okay.

MR GOW: But the suggestion that governments use other regulatory measures to achieve what some might argue is a level playing field, or competitive neutrality, is something we couldn't agree with.

MR BANKS: You have talked about charging and the NRTC's national charging regimes and how that has evolved. I think you said the upshot has been somewhat over-recovery from light vehicles. I think others have contended that there has been under-recovery from heavy vehicles. Do you want to respond to that?

MR GOW: The NTC's documentation does show some under-recovery, but each category of vehicles has under and over-recovery within itself. For example, with articulated trucks, the average distance that the NTC uses per year is 112,000 kilometres, so they average the vehicle mass or freight carried and distance travelled within each vehicle class, and one of those is your standard workhorse of the industry, the six-axle artic. If you look at the graph at 112, there are six-axle artics which travel less than that and others that travel more than that.

Within that category itself, the guys who travel less than 112,000 kilometres

are, in fact, being over-recovered and those who travel more are being under-recovered. If you look at the graph in the paper put out by the National Transport Commission in July 2003 as part of the third charges determination - their general principles paper - I don't have a degree in maths but, when one line is a mirror image of the other, I think that indicates that they are equal and, in fact, the under-recovery within artics seems to be equal to the over-recovery within artics.

MR BANKS: Yes.

MR GOW: The only area where registration fees are not as large as the formula would indicate is with B-doubles and road trains - and that's registration fees - but with these vehicles, because they're paying, under the current arrangements, 20 cents of their excise on each litre used, the further they travelled the more 20 cents's they paid and I'd strongly contend that they are recovered through their road-user charge with the net excise arrangements of 20 cents per litre. I have done some calculations and, of course, each of those graphs is based on an average fuel consumption for those categories of vehicles.

We're not satisfied that the average fuel consumption that's used in the second charges determination reflects current practice. On our figures, in fact, by changing that - based on industry figures, of course - you can show that there's over-recovery as well there. With the second charges determination - the area where we do have the stats - you can argue that case but, as I hope I've demonstrated, you can argue a counter-case as well, if necessary, and we're quite capable of doing that.

MR BANKS: Could I encourage you to have a look at the submission - if you haven't already seen it - from Pacific National to this review, which was discussed in the hearings in Sydney on the first day. They've got some quite detailed analysis about the basis, I guess, for their arguments that there's still a problem in relation to road charging - or under-charging - for trucks but, rather than go through it, perhaps if you have a look at that and, if you'd like to comment on that, feel free to get back to us.

MR GOW: Thank you for that offer. We don't necessarily want to engage in a debate with rail interests in this forum, or any other forum.

MR BANKS: It's more a matter, I guess, if they have made comments that bear on your interests or your own calculations, that you have an opportunity to set the record straight with us, but it is up to you whether you do so or not.

MR GOW: What we're waiting for is the technical report to be issued by the National Transport Commission in February-March next year. Then we'll have up-to-date data. Speculating on the technical report that surrounded the second

charges determination, which came out in 1998, is not necessarily a fruitful exercise.

MR WEICKHARDT: What you said about over and under-recovery in particular classes, of course, makes sense. I'm wondering whether you have an average, some over and some under, which really brings me to this issue of mass distance charging, which some have claimed is difficult; problematic. Experiments in Germany and others have been cited as being a disastrous failure and others have said technically it's well and truly possible. Do you or your association have a view on whether or not this would be a useful step forward in terms of genuinely getting the costs associated with particular loads and particular routes adjusted to equal the charges?

MR GOW: A few points there. Firstly, it has been touted that, because mass distance charging has been or is being introduced in Europe, it - at the very best - is a bloody good thing and - at the worst - should be seriously considered. Europe is a very different situation to Australia, of course, where our heavy vehicle cost-recovery system is based on fuel tax and registration. I might add that, between the two of them, yields to the Australian government is about $1.6 billion per year.

It's not a small amount of money that's recovered from heavy vehicles in Australia - that's almost equal to the average figure of Commonwealth roads expenditure actually, historically - but that money goes through the fuel charges to the Commonwealth and about 600 million of it through the registration charges to the states. In Europe those pricing instruments are not available for transit in traffic. If you're in Germany, let alone Switzerland or a smaller country, people drive across your country; their trucks are not registered in your country; they're not buying any fuel in your country. You're not recovering any of the cost of their use of road, so it's logical you have got to look at some other instrument. Australia, until we get a tunnel to somewhere, doesn't have that situation. We would suggest that the instruments here are tested and valid ones for Australia.

The argument that mass distance charging, because it's being introduced in Europe, should be introduced here just doesn't recognise the fundamental difference between the road transport industry and the two situations and the problems of governments in Europe recovering the cost of their road use. It depends what you are calling "mass distance charging". As I have explained a little, we already have mass distance charging for heavy vehicles in Australia. The further they drive, the more fuel they use and, therefore, the more road user charge they pay, which is 20 cents of the 38.143 cents excise. The remainder of that is returned to most heavy vehicles - or at least the heavier vehicles, over 20 tonne - through the On Road Diesel Grants Scheme administered by the Commonwealth under the Energy Grants Credit Scheme. The further you travel, the more fuel tax you're paying, the more excise you're paying; therefore, the more you contribute, and that's already calculated in.

Also the mass of the vehicle is calculated in through the measurement of its pavement loading. For a heavier vehicle, there is more recovery from that vehicle because of its weight, so we already have a system of mass distance charging. I think the mass distance charging scheme you're talking about is very much based on individual, rather than vehicle, category mass distance charging - - -

MR WEICKHARDT: That's right.

MR GOW: - - - and locational as well. The implications of that are, frankly, huge and we're still grappling with them. For example, with a truck running down the Hume Highway on the concreted sections adjacent to Canberra here, engineers tell us there's no pavement wear and damage issue at all. Presumably, if you actually include the road type that the individual vehicle is on - it is included in the averaging figures done by the NTC, how there are different road categories - one could argue that, with running a B-double down the Hume Highway, there should be no cost recovery because you can't damage a concrete pavement that's 12 or 15 inches thick. With a gravel road out in the bush somewhere that hasn't got any subbase or base and isn't surfaced, doesn't have a chip seal on it, it's logical to say that the potential wear on that road is much higher.

In Australia, with such huge distances to move our freight over, if you pursue that argument logically to the end, the charging on those vehicles - productive vehicles in the rural areas of Australia - would be so high that it would make us uncompetitive internationally or, in fact, the problem of moving freight locally. You know, with regional communities, their Weeties would double in price. If you're going for true mass distance charging that includes the sort of road and everything else, the implications from what we've got now, the averaging system would need to be very seriously thought through before it was seriously proposed by anybody as to its impact on the Australian economy.

The other area, of course, is how you actually set up a compliance and enforcement regime for such a system. In New Zealand, they have a mass distance charging regime but in a small country, even though that is an island, it does make more sense. In a big country, there seems to be fundamentally a tension there. But you purchase certificates to run in advance of doing that running at the post office - not a system I'm advocating for anywhere - through to requiring telematic sort of solutions with vehicles through GPS, et cetera, to know exactly where vehicles are and, therefore, calculate their charging. It's a huge administrative cost to set up such a system, and one of the principles that underlies the current heavy vehicle charging system in Australia - and taxation generally - is simplicity, and that is built into the current heavy vehicle charging regime.

To move away from it to a mass distance regime, particularly if it was

individually based and locationally based, is something that would need to be proceeded with very carefully. The final point about this is whether you're using that, in fact, to recover the pie or the slice of the pie that's currently recovered from heavy vehicles under the current system. Maybe there are other ways to look at recovering what is the allocated expenditure to heavy vehicles under the current system and mass distance charging may be a way to look at that. If mass distance charging is just a way to increase the pie, or the slice of the pie, then you'd have even greater over-recovery than there is now.

MR WEICKHARDT: You may do. I mean, society is bearing the costs of road wear now. It would, in theory, if it was technologically possible without all the complexities you've described - and I can understand those - convert the costs that are being borne by the community now into a user-pays situation. So, yes, perhaps your Weeties would be more expensive but perhaps your taxes would be lower.

MR GOW: Perhaps.

MR WEICKHARDT: Anyway, I understand the debate.

MR BANKS: You seem to be agreeing with our judgment that such more sophisticated road network pricing is some way off before it could be introduced. That also was challenged, I think, by Pacific National. They thought we were being somewhat too pessimistic in that direction. Thank you for your comments on that.

MR GOW: I'll just add that, within our federal structure, the question of collection and redistribution of funds, et cetera, under an individual vehicle charging regime is also extremely complex. That's one of the complexities that underlies that proposal from the NTC about incremental charging, which we strongly support, but who collects it and how are the moneys redistributed from such an incremental charging regime is a really tricky question and may make achieving that aim very difficult, if not impossible, unfortunately.

MR BANKS: All right. Thank you very much.

MR GOW: Thank you for your time this morning.

MR BANKS: We'll break there for a moment, please.

MR BANKS: Our next participant this morning is the Grains Council of Australia. Welcome to the hearings. Could I ask you to give your names and positions.

MR GINNS: David Ginns, the chief operating officer.

MS BROKUS: Caroline Brokus, policy manager, trade and marketing.

MR BANKS: Thank you very much. Thank you for attending the hearings today and for your submission. I don't believe you made a submission in the first round but you've made one now. We haven't really had a chance to look at it in any detail. We did receive it this morning and, therefore, would appreciate it perhaps if you'd go through the key points in the submission, perhaps beginning by just indicating the membership of your organisation and its function.

MR GINNS: Okay. Our organisation was established about 75 years ago, the Grains Council and its forebears. Our membership is made up of five state farming organisations that collectively represent the voice of grain producers in Australia. Those states are Western Australia, South Australia, Victoria, New South Wales and Queensland. Tasmania, with its small industry, is an associate member of ours. The Grains Council is a member of the National Farmers Federation, and we are actively involved in the policy deliberations and policy deployment.

MR BANKS: Thank you.

MR WEICKHARDT: Is the Australian Wheat Board a member of the Grains Council?

MR GINNS: You mean AWB Ltd?

MR WEICKHARDT: Yes.

MR GINNS: It's a point we just need to clarify. The Australian Wheat Board hasn't existed for about five years now. So, AWB Ltd, no. Our organisation is made up of producer representative organisations. We're an association incorporated under the Associations Act in the ACT.

MR BANKS: And its relationship to the Grain Growers Association?

MR GINNS: We obviously operate in the same industry. The difference between the Grains Council and our members and the Grain Growers Association is that Grain Growers is the owner of GrainCorp, the organisation that controls most of the handling and logistics and storage for grain on the east coast of Australia. They primarily represent the interests of shareholders in that organisation. They have quite

different policy objectives to those of our member organisations. The policies of the Grains Council are determined by the five organisations that are members of ours.

MR BANKS: Okay, thank you.

MR GINNS: As you say, I will go through the submission fairly quickly. We'll just start off with the background of the industry and refer to a comment from, I think, the hearing that was held on 30 November in Sydney. Australia produces about 4 and a half per cent of the world's wheat but we comprise about 15 per cent of the world's wheat trade. I notice that there was a comment in the hearing in Sydney that was made about that figure of 4.5 per cent and it giving us very little market power. That is not really the case, because the global trading market for wheat is about 100 million tonnes, and we export about 15 to 16 million tonnes, and the figure of 15 per cent is generally accepted as being one that enables you to have some pricing influence on a market.

MR WEICKHARDT: Who is that generally accepted by?

MR GINNS: It's generally accepted in the marketing and commerce texts that I studied when I was at university and by other people that I've spoken to over time. It's not accepted by you, of course, but that's fine. I just wanted to correct that particular issue. At our market share of 15 per cent of the 100 million tonnes that are traded globally of wheat, that Australia is able to, through its current marketing structures, offset some of the problems that we face in global wheat market competition, which is very much the core of our submission that the current wheat marketing arrangements - and that's really the issue where our concern lies, with the activities of reviews of competition policy and other particular issues related to that; is the basic perspective that the wheat industry in Australia is around about 75 to 80 per cent export.

Because it is very much an export oriented industry, our policy position is that we need to approach our macro policy setting for that industry from a perspective that is cognisant of the fact that only about one in every five tonnes of wheat that is grown in Australia is used domestically - the rest of it ends up overseas - and that we're competing with some very large transnational corporations in the trading activities of the global wheat trade. Four of them, collectively, control about 73 per cent of the global wheat trade and Australia being able to influence and to be able to manage 15 per cent of that enables us to offset some of those competitive pressures.

MR BANKS: Could I just perhaps ask on that - and I agree that if that could be possible and achievable, and you've got some studies in here which indicate that - why was that not found in the earlier NCP review of wheat marketing?

MR GINNS: My understanding and reading of the reviews is that they have taken an overly domestic view of the operations of the industry and there has been a lot of comparison with other industry sectors that are, by their very nature, quite different to the wheat industry itself. One of the recent ones is the good work that Mark did on barley, in this report that only came out fairly recently.

Whilst we have no problems with the study and the methodologies and all that sort of stuff that went into it, unfortunately what people have done is taken the conclusions and recommendations out of this that looked at barley and canola and have applied them to the wheat industry and, if you look at the fundamentals of both industries, they're quite different.

MR WEICKHARDT: Can you explain why they're quite different?

MR GINNS: The first is the overt export orientation of the wheat industry. That 80:20 is quite an important determinant, I think, in how you should be forming policies for the wheat industry; the global nature of the wheat trade, as I referred to, with the domination of the four transnational corporations; global buying patterns. For wheat, of course, there are a lot of single-desk purchases, particularly in our major destination countries such as, I think, South Korea, Saudi Arabia, Iraq, Japan and there are a couple of others. So we have quite a different set of fundamentals operating in the wheat industry than in the barley industry or the canola industry or the meat industry or whichever industry you'd like to compare it - - -

MR WEICKHARDT: None of those characteristics, you say, are similar to barley? For malting barley, for example, I understand that Australia's global share is 25 per cent.

MR GINNS: Of a very much smaller market.

MR WEICKHARDT: But if your theory is that at 15 per cent market share you've got pricing power, at 25 per cent market share - global market share to a very selective buyer in Japan - surely you'd have acute pricing power, and yet this study didn't demonstrate it, so why is it different?

MR GINNS: You've also got to factor in the different use of the end products. The different uses of the end products in barley are quite remarkably divergent from those in the use of wheat. Malting barley basically goes into the preparation of beer and malt-related drinks. There's a whole plethora of products that milling wheat goes into and, from a consumer market perspective, the drivers of those markets are quite different. To just approach it from a market share perspective or a simple statistical analysis I don't believe is appropriate. You've got to look all the way through the

value chain, through to the end use products, and look at the dynamics of what particular drivers there are. Once again, there's a fair divergence between malting barley and wheat.

MR WEICKHARDT: I don't think we'd have any disagreement that you have to look closely at it.

MR GINNS: Yes.

MR WEICKHARDT: The question is why you and various other people don't want it looked at closely.

MR GINNS: I didn't say that we don't want it looked at closely. I think if you looked at the whole value chain and you accounted for all of the different drivers, you would see that wheat is quite distinct from the others; quite distinct.

MR WEICKHARDT: So you're supportive of the fact there should be a thorough open transparent investigation into the single desk under NCP principles?

MR GINNS: There's one, I gather, scheduled for 2010. We're on the public record of agreeing to the process that's scheduled for 2010, and it should go ahead, but not before.

MR BANKS: Just coming back to the one in 2000, which recommended that another review should occur in 2004, are you saying that earlier review in 2000 didn't take an international perspective? It was just locked in a kind of domestic mindset and therefore missed - - -

MR GINNS: From what I've seen and been able to look at, yes, and I gather we're talking about this one. That's some of the background to it?

MR BANKS: No, we're not. We're talking about the review of the Wheat Marketing Act - - -

MR GINNS: That would be some of the background, wouldn't it?

MR BANKS: No. We're talking about the review of the Wheat Marketing Act that was conducted by an independent panel.

MR GINNS: Right. This is not the 2004 review?

MR BANKS: No. The 2004 review, as you know, was not a review of statutory marketing, in that sense of the single desk.

MR GINNS: It was a review of the act, wasn't it?

MR BANKS: It was a review of the operations of it, yes.

MR GINNS: That's right, and that review found that it was operating quite well and recommended that there be no more reviews until the 2010 NCP review.

MR WEICKHARDT: Yes, but its specific terms of reference said that it was not a review under NCP principles of the single desk - - -

MR GINNS: That's correct. That was, I think, the last sentence of the first terms of reference. That's right, but it did find that it was meeting the terms of the act and that it was serving the wheat producers of Australia well.

MR WEICKHARDT: If it wasn't a review that took into account all the factors, I don't see how it could reach that conclusion.

MR GINNS: You're questioning the findings of the independent panel review and saying that they're invalid?

MR WEICKHARDT: No. I'm just saying the terms of reference specifically excluded it from looking at the very issue that we're talking about; that is, the function of the single desk in an export market and whether or not it added value.

MR GINNS: However, it found that - as had the operations of the WEA in their grower reports - it does add value.

MR WEICKHARDT: We've only seen a six-page extract of that report - - -

MR GINNS: Which report?

MR WEICKHARDT: The most recent report that you're referring to.

MR GINNS: The 2004 review panel? Yes, so have we, and the recommendations were fairly clear and they're with regard to the performance of the act and the marketing arrangements.

MR BANKS: Could we go back to the review that was actually looking at the single desk; the one that was conducted in 2000, which did recommend that another review occur in 2004, which hasn't happened. Are you saying that that earlier review wasn't a comprehensive review? It had a lot of submissions. It was a transparent review. Unlike the most recent one, its report was public and open for everybody to

have a look at. It had some experts on that review group, who I think were capable of taking a broad perspective. Why do you feel that its recommendations or findings were not valid?

MR GINNS: Our policy position is that the finding that brought into question the current export marketing arrangements was invalid. Our organisation did not agree to the outcomes.

MR BANKS: Do you mind explaining why?

MR GINNS: It was a policy decision made by our members, and I'm not in the position of questioning them publicly on that.

MR BANKS: All right. Look, we'll let you proceed. We've stopped you part-way through your presentation.

MR GINNS: Just going through to page 5 of the submission that we've sent through, we've cited there some evidence of recent studies and of the Wheat Export Authority, indicating that there is significant value added through the pooling mechanisms allowed for under the current export marketing system that add, to the minds of those that carried out the study, significant value to Australian producers.

MR BANKS: Is this a study that's publicly available?

MR GINNS: The Econtech one? Yes, indeed. That's that one there.

MR BANKS: Could we get a copy of that?

MR WEICKHARDT: That Econtech report was commissioned by the AWB. Is that right?

MR GINNS: Yes, as were various reports that were in opposition to the AWB, commissioned by the likes of GrainCorp and the organisation that owns it. If you want to sort of question the integrity of the outcomes, you've got to look at previous reports like, I think, the Accenture report and the Kronos report that disprove what's in there and see who commissioned those reports as well. I raise that point just for the sake of fairness.

MR BANKS: In other words, you'd agree that reports commissioned by independent bodies like the National Competition Council - or, indeed, in the case of the 2000 review of the Wheat Marketing Act - wouldn't have the problem of perception of client relationships.

MR GINNS: That's not necessarily a problem of perception that I have. Over to page 6, we just continue there where we're talking about some of the model losses that Gans and Hirschberg talked about from changing the current structure of the wheat marketing system. You'll see further down that page where we talk about the international focus of the Australian wheat industry and I make mention there of some of those matters relating to the size of the global trade for wheat and the domination by transnational corporations. I just refer you particularly to the US dollar turnover of those four companies there, being around about $150 billion per year.

I'll just make the comment that they are very much globally and vertically integrated companies that are able to leverage supply from various sources around the world, and that gives them a major competitive advantage. It's our policy position that the major competitive advantage that Australia is able to exercise in the global wheat market is through its ability to be able to trade under a single brand, as it were - the 15 or 16-plus million tonnes a year that we export - rather than having a situation where that level of export is divided up amongst a range of different people and possibly competing against each other in the same market. If we go over to page 7 - - -

MR WEICKHARDT: Can I just try and understand some statement you make on page 6 before you move on. You say on page 6 that the 15 per cent market share is a critical point at which a seller can influence price movements.

MR GINNS: Yes.

MR WEICKHARDT: So, what, you're saying anything above 15 per cent you think you've got this power and below 15 per cent there's suddenly a tipping point?

MR GINNS: I think that we've had the discussion on where you and I disagree on that philosophy of 15 per cent being able to influence prices and, yes, from the marketing and the commerce texts that I read at universities and at other places, that's a generally accepted principle. It's one that's used by, I think, Rupert Murdoch and his family shareholding in News Corp, for example.

MR WEICKHARDT: The 15 per cent, I guess, is an average, is it, of Australia's market share?

MR GINNS: Yes, generally.

MR WEICKHARDT: And I assume that in good wheat seasons our market share is higher than 15 per cent.

MR GINNS: Yes.

MR WEICKHARDT: And in bad wheat seasons our share is lower than 15 per cent.

MR GINNS: It is, but that is offset by the activities of a wholly owned subsidiary of AWB Ltd, which is AWB Geneva, and in the last serious drought AWB Geneva was able to source wheat globally to place in the contracts that it already has, to maintain the relationship that existed between AWB International and its overseas buyers. In effect, what AWB there was able to do was to trade in a similar way to one of those big four, and that's something that is certainly beneficial for Australian wheat producers because they were able to maintain those contracts.

MR WEICKHARDT: Are you saying the big four have market power themselves?

MR GINNS: Very much so, yes.

MR WEICKHARDT: Okay, so your point is not that they'd get lower prices in selling.

MR GINNS: Who wouldn't get lower prices?

MR WEICKHARDT: The big four. You say they've got equal market power or maybe greater market power.

MR GINNS: They would have greater market power, because they are able to source their supply from various sites around the world, and they have greater market power for themselves, not necessarily for those people who they're purchasing grain from. I mean, those organisations are traders. They're purchasing grain from producers and selling it at a margin on behalf of themselves. The difference with AWB International is that it's purchasing grain from producers into a pool. It's then selling in that pool globally and then distributing the returns back to the producers that they've purchased grain from originally. So it's quite different to the way the other four work.

MR WEICKHARDT: Yes, but I want to understand this point. Your contention and concern about the big four, therefore, is not that they won't get equal selling prices to AWB International. In fact, you're implying, I think, that they might get better selling prices because they've got even more market power.

MR GINNS: No, I'm not implying that at all. What I said was that they are able to leverage their own individual margins by, in a lot of cases, depressing the prices that they pay for grain and then selling them into the world market, which is quite a

different marketing operation to the way AWB - - -

MR WEICKHARDT: But if their global market share is bigger than AWBI's, why don't they get higher selling prices?

MR GINNS: Once again, this is where you get into issues of quality, issues of supply and issues of relationship. I'll give you a good example. We've just seen the 56th anniversary of wheat trading between Iraq and Australia, where I think over that period of time we've sold in excess of 30 million tonnes to the Iraqis. That ongoing relationship has been very valuable to Australian wheat producers, and one of the central facilitators of that relationship is the fact of the operation of AWB International into that market and the way it operates not as a trader but as a seller of producers' wheat.

MR WEICKHARDT: I note you say it's been a very profitable relationship, but has it been for Australia, after the debt we've forgiven to Iraq?

MR GINNS: Yes, it has indeed been to Australia, even if you take off those contract defaults. If we had been selling that same wheat into equivalent markets, either in the Middle East or anywhere else around the world, we would not have got the returns that we got out of Iraq.

MR WEICKHARDT: We've just forgiven $250 million of debt.

MR GINNS: No, that's not the figure.

MR WEICKHARDT: No?

MR GINNS: The figure that was published by DFAT was a figure that was based on accrued interest and interest penalties over a period of 12 or 14 years. If my memory serves me correctly, I think the original figure was around about US490 million.

MR WEICKHARDT: Of debt forgiven?

MR GINNS: Yes, that's right.

MR WEICKHARDT: We must have been extracting a very big premium if we've made up for that.

MR GINNS: We have been selling into Iraq on the basis of the fact that it is and has been a high-risk market, and you obviously are able to extract a premium from a high-risk market. I might just clarify "high-risk". It's not a credit risk. It's a trading

risk environment, where there is the possibility of shipments being lost.

MR WEICKHARDT: They secure it.

MR GINNS: Yes.

MR BANKS: I'd just be interested in your comments on whether you need a monopoly over all export of bulk wheat to deal with those particular markets where you see a single buyer being particularly important. Couldn't you have an arrangement whereby you had a single seller in that situation to, say, the Iraqis, but had more liberal arrangements for selling in other parts of the world where those particular arrangements didn't apply?

MR GINNS: The big problem with that sort of arrangement is that the key to the current pooling system is that AWBI are able to aggregate the whole of the crop, they're able to look at what quality and what quantities are available nationally, and they're able to segregate and place the most appropriate wheat into the most appropriate market and, of course, then bring the benefits back to the pool. If you had a situation where the theoretical exporter that you're talking about there had a much more limited choice of what wheat it could draw upon, what grades and what quality it could draw upon, then you would see the basic undermining of the whole system.

MR BANKS: But why would it be more limited? Really, wouldn't they be competing in the market to get the sort of wheat that they thought would be appropriate for the export destination they had in mind?

MR GINNS: In a theoretical sense?

MR BANKS: I'm just thinking in practical terms whether what you say would be right or whether they'd still have scope to essentially acquire the wheat that they thought was appropriate.

MR GINNS: They can. Anyone can acquire wheat domestically, but as I said earlier, the whole key to the way in which the pooling system works is allowing for the manager of the pool to be able to look at 15, 16 million tonnes or whatever the figure may be domestically and to be able to place that in guaranteed quantities over guaranteed time lines into certain markets with very good-quality specifications, and also to be able to back that up with technical expertise and end-use expertise on the ground in the actual country of use. That's something that not many people think of when they criticise the current system that we've got. There is a hell of a lot of in-market end-use support and technology that goes into the markets that we deal with, which is all part of that relationship with the buyer, and that is quite different to

a lot of the traders, who are simply sellers of a product.

AWBI at the moment does provide a lot of use technology, and that is a primary benefit to Australian wheat producers because it means that the customer is using our products, which are as good if not better than anyone else in the world, and they're using those most effectively and most efficiently, having a benefit in that market that we're selling into, and of course that then encourages those people not necessarily to buy wheat from Australia just on a price basis but on a quality and service basis, which is a much more sustainable way of selling wheat rather than simply on a price basis, which, as we know, is a downward spiral for prices.

MR WEICKHARDT: If in bad years AWBI is able to accumulate wheat from other buyers so they get their market share back up to 15 per cent - - -

MR GINNS: You're talking about internationally?

MR WEICKHARDT: Yes, and that gives them this market power, say if some states, as in barley, licensed other exporters and AWBI's share dropped below the 15 per cent level, why wouldn't they be able to accumulate grain internationally and retain their market power?

MR GINNS: You see, once again you're comparing barley arrangements in Australia with wheat.

MR WEICKHARDT: No, I don't think I mentioned - - -

MR GINNS: You did mention barley. You mentioned barley, grains, licensing.

MR WEICKHARDT: I'm trying to understand the issue as to why, if AWB or AWBI were not the single desk, they couldn't retain this market power, given the example you've quoted.

MR GINNS: This is purely a theoretical or hypothetical argument and subject to opinion. I don't think I can supply you with an opinion on that because it's purely a hypothetical situation.

MR BANKS: Okay. Perhaps come back to where you ended up.

MR GINNS: Yes. I just want to refer to page 7, where I raise the issue of the international competitiveness and the international nature of the wheat market that we deal into. We've raised that issue. If you have a look in the bold text there, we're talking about Australian companies being able to become large enough to compete effectively in the international marketplace by lessening competition in Australia,

and I just cite the example of the pragmatic approach that's been taken by New Zealand with the formation of Fontera, where they combined the entities of the New Zealand Dairy Board, the New Zealand Cooperative Dairy Co Ltd and Kiwi Cooperative Dairies to form a fairly large national - - -

MR WEICKHARDT: With respect, you've just told me that wheat is unique, nothing like barley, so why should I believe it's anything like milk and dairy products? Why didn't you quote coal or iron ore or - - -

MR GINNS: The principle here is that the New Zealanders have seen the value of being able to form a company with a very, very large capital base and a very large turnover, to become one of the top probably I think seven dairy companies in the world, to maximise the value that New Zealand extracts from the international market from its dairy exports. I'm simply raising that issue there to say that that is an approach that New Zealand have taken that falls more in line with the perspectives that we have, that line up with the current arrangements for wheat export, where we have said that aggregating all of our wheat exports, effectively under the umbrella of one company, enables us to compete more effectively on an international market.

I raise the issue of Fontera there because that is a, to our mind, complementary approach. It says that there is a balance between looking at domestic competition policy and the export focus of a particular industry. The New Zealanders in this case have said more than 80 per cent - probably 90-plus per cent - of the output of the New Zealand dairy industry goes into the global market. They have decided it's best for the competitiveness of New Zealand dairy products for those to go under the banner of, or the umbrella of, one particular company; to take out "own country" competition which used to exist between New Zealand Cooperative Dairies and Kiwi; to focus on their competitors in the global dairy industry. That's a principle that very much backs up our support for the current structure that AWB has with the export of wheat. So I'm not making comparisons between milk and wheat; I'm making comparisons between the philosophy of balancing domestic market issues over international market issues in an industry that is overwhelmingly focused on exports.

MR WEICKHARDT: So the coal industry, for example, would fit that model?

MR GINNS: I don't know enough about the coal industry to be able to make a comment.

MR WEICKHARDT: Australia's largest export - probably over 80 per cent is exported.

MR GINNS: Right.

MR WEICKHARDT: Big single buyers.

MR GINNS: Right.

MR WEICKHARDT: Okay.

MR GINNS: As I say, I don't know enough about the coal industry to be able to comment. On page 8 we've just included some material. I don't know whether you have seen a copy of that but that's a summary of our industry strategic plan. I can give you a copy of that if you like. There, reference is made to the historical decline over time - and that graph shows between 1960 and 2002 - of undifferentiated commodities such as wheat going into the world market. We note that there because we believe that the current wheat marketing arrangements provide Australia with a perfect opportunity to start to differentiate its wheats based on more defined quality characteristics, regional sourcing and other branding issues that will, from a marketing perspective, allow the international marketer to differentiate our products more effectively from those of our competitors.

On the next page we've just included some notations there from the Wheat Export Authority to allow - a growers' report - we've included that in response to some criticism that's been made from various parts of the agricultural sector that during the drought of 2001 to early 2003 - that the single desk was not acting in the best interest of other industries. It clearly shows there from the WEA's official figures that there was a major divergence of wheat from the export pool into the domestic market which helped to alleviate the rather exceptional circumstances that were affecting feed grain and other supply of wheat in Australia. I think there were some imports of milling wheat and imports of feed wheat to supplement that at around about that time simply because the drought was so devastating in the eastern states and through South Australia. Really Western Australia was the only state that had a decent crop around that time.

We've made some mention at the bottom of page 9 about the people involved in the industry. There are currently around - the figures vary depending on who you talk to but we tend to work on about 30,000 to 35,000 producers in the grains industry and employment figures directly of about 150,000. Close to 45,000 non-farm enterprises rely on the grains industry. Those figures are derived from the AWB source quoted at the bottom of the page. Mention is made there on the top of page 10 about some of the opponents of the current arrangement and some of the potential impacts of shifting what we call "at silo" export arrangements to an "at port" model.

It's our opinion that that model is clearly a tactic by organisations which

control storage and handling and other parts of the logistics chain to capture more of the value that is able to be brought back out of the pooling system that currently is returned directly to producers - to capture more of the value for themselves by increasing their infrastructure rent. That's not something that we would like to see because that represents a fairly major equity shift directly from producers to shareholder equity in these companies. We don't believe that regional economies should be disadvantaged in that way.

At the bottom of page 10 I've made some comments about that NCC occasional series review that was made where opponents of the current wheat export marketing system have taken the findings that related to the barley and canola industry and applied them to the wheat industry which is not appropriate and I think devalues the work that is included in that particular report. But it's something that we had anticipated. So that then takes us to the recommendations. I don't know whether you want to spend time going through those recommendations one by one? They're there and they're on the record.

Basically our perspective with regard to the application of full deregulation to do with wheat export is that we believe the international marketing parity should override the concerns of any anticompetitive arrangements that may be applying to the domestic market, mainly as I've explained here today that it is very much an export-focused industry. Apart from those few people who grow wheat specifically for feed, as a rule of thumb you could say that just about every wheat producer grows wheat with the ultimate aim of having that exported into the higher value export markets. Clearly in the minds of the participants in the industry it is an export-oriented industry and we believe that it is that sort of perspective that should be taken to any changes or any proposed changes of the current legislation.

MR BANKS: Okay. All right. I appreciate your bringing those points to us and I think we've had some useful discussion. You've made the point repeatedly, I guess, that you can't compare grains with grains - you know, like the old saying "oils ain't oils".

MR GINNS: That's right.

MR BANKS: However, there is one dimension on which I'd just seek your comment. In the case of barley and so on what happened when growers were given a choice is that they exercised that choice and that the incumbent responded to that to some extent. Why would you not allow choice to occur in relation to wheat? I mean, if the existing arrangements are delivering these benefits for growers why wouldn't you expect that they would continue to vote with their feet in favour of existing arrangements?

MS BROKUS: There is a great deal of wheat that is acquired by traders in Australia and certainly growers do take advantage of that opportunity. I'd certainly cite a South Australian example of an activity with the Ausbulk Grain Marketing division that acquired 1 million tonnes of wheat.

MR WEICKHARDT: For the domestic market.

MS BROKUS: For domestic markets but I think it's important to acknowledge that once those domestic markets have been filled, there is a very transparent and well-utilised function of our current arrangements whereby traders may transfer grain into the national pool. Obviously those traders, as pool participants, also benefit from the performance of that pool and are a significant player within the national pool. So therefore growers at the point of harvest - if they seek to maximise their cash returns during a normal year obviously may take advantage of those traders operating. So there has been that utilisation by growers at harvest to actually contract grain to alternate traders which ultimately may end up in the national pool, but certainly that function is there.

MR GINNS: Yes, that is an extremely good point that you've got. You've got people who want to sell grain for cash - producers who want to sell grain for cash at harvest time and they'll do that to any number of traders, whether it's a large trading house or whether it's the trader in the local town. In a lot of cases, those traders will then on-sell that grain that they have purchased into the national pool to take advantage of the current export marketing system, because it has been proved time and time again that pooling arrangements are quite beneficial to those people who participate in them. You do have a lot of people who are traders taking advantage of that. It's not just growers who sell into those pools.

Back on the barley issue, you do have within the barley industry essentially two distinct industries in themselves, and that's the feed barley market and the malting barley market. You have a lot of people who grow barley simply for feed. They do that because barley generally will be a higher yielding variety to wheat, if it's a feed barley variety, which means that they will be able to get a greater return per hectare than they would in yield terms for growing wheat. The gross margins in a lot of areas of growing barley for feed and selling it direct into the domestic market are higher than growing wheat for the export market.

A lot of producers diversify their risk, not only with varietal types within wheat, barley or other cereals or oilseeds or summer crops, but they also diversify their spread of risk at the end of the year, because different crops - different varieties of barley or different varieties of wheat - will be able to be harvested at different times, so the harvesting period will be going over a couple of months. That's why they sort of swap between various crops, and they're not just growing monocultures.

On the other side of the barley industry you have malting barley. You have people who grow specific types of barley specifically for the malting industry. It is a much more technically difficult crop to grow because the quality parameters for malting barley are much narrower, and you do get a significant leakage out of malting varieties, based on quality back to the feed barley industry.

So it's not just a case of saying barley is just one industry. There's a couple of really distinct streams within that, and we have to be cognisant of the fact that a lot of the barley that's produced in Australia is just produced purely for the domestic stockfeed market. Some of it is exported, and the same goes with malting barley.

MR BANKS: Okay.

MR WEICKHARDT: I guess I still scratch my head that at the end of the day, I think national competition policy, and certainly I personally would be very satisfied if it were demonstrable that the premium that you're describing were achievable in the export market, and this was delivering net benefits to Australia.

MR GINNS: It is demonstrable, and I refer you to the studies of Gans and Hirschberg.

MR WEICKHARDT: Sorry. Can I just finish, please?

MR GINNS: Yes.

MR WEICKHARDT: If it were demonstrable, then I think we would be all in heated agreement. Why the industry doesn't want an independent re-examination of that - - -

MR GINNS: We've agreed to the re-examination that has been - - -

MR WEICKHARDT: In 2010.

MR GINNS: Both the federal government and the federal opposition have committed to that in writing, that we will be having the reform in 2010. The independent panel review recently handed down their findings, and said that it's appropriate to have the scheduled 2010 review go ahead, and we're on the public record as saying that we look forward to the 2010 review when it comes up in 2010 and not before.

MR BANKS: Could I just say, if you're going to persuade us, the commission, to change our view that that review should be brought forward, could you tell us what

the - - -

MR GINNS: No, we don't want it to go forward. We want - - -

MR BANKS: No, but just tell us why that should not happen. I mean, what would be the problem or the costs relative to the benefits of having an earlier review?

MR GINNS: The 2010 review is scheduled. We've not been presented with any evidence to date that says that a review earlier than 2010 is warranted.

MR BANKS: Could I just say there was a very strong set of evidence that came out of the 2000 review which included suggestions that - - -

MR GINNS: That was the opinion of the - - -

MS BROKUS: There was a very strong recommendation from the 2004 Wheat Marketing Review that we stick to the current time line as enshrined in the Wheat Marketing Act 1989 that we actually retain the time line for the 2010 NCP review. They cite that any additional reviews would simply impose unnecessary costs and inefficiency on the operations of AWB International and the industry as a whole.

MR BANKS: The only problem I have with that is it's a secret report.

MR GINNS: It was a report - - -

MR BANKS: It doesn't convince us if it was a secret report. I mean, that's the problem, and I think this is a public issue that is not best served by a secret report.

MR GINNS: That's an issue that you probably should raise with Minister Truss's office.

MR BANKS: What's your understanding as to why this report hasn't been released?

MR GINNS: My understanding is that it was a report that was commissioned by the minister, and that it is general practice with those sorts of reports that a report goes to the minister, the government will respond formally and publicly, and we have been informed that they will be doing that, and that there is a generally accepted time line for that, and that the response from the government will come out within that generally accepted time line.

MS BROKUS: I think it's important, too, that time must be now provided to the industry to implement the extensive structural and administrative reforms of the operation of the single desk following the 2004 review. Certainly we have seen both

AWB International and the Wheat Export Authority already position themselves for such implementation.

MR GINNS: You see, the problem we've got is that we've just had this review of the act and there's a stack of recommendations. As Caroline correctly said, we've got the two main parties - AWB International and WEA - and the Grains Council of Australia is involved in what we call the consult group, which is a group that looks at the oversight that WEA has of the act. There are time lines and there are time restrictions that are placed on how and what AWBI can do. It's putting together a series of changes to propose to its AGM in March, and that's a time line it can't speed up, because it's a publicly-listed company, and it has to adhere to the time lines that are laid out under Corporations Law. We are pleased that they have announced a package of reforms in line with what the independent panel has outlined, and that they're going to take those to shareholders for them to judge in March. We know that the WEA is looking at the recommendations and is putting together a formal response as well.

MS BROKUS: Obviously, in the 2010 review, it will provide an opportunity under NCP principles to examine the effectiveness of the implementation of these recommendations, and obviously the performance of the current wheat export arrangements over that time, from 2004 to 2010, following structural reforms.

MR WEICKHARDT: The great irony and tragedy for your members is that if the 2010 review concludes that this wasn't adding value, you've just lost six years, but anyway.

MR GINNS: I guess I would be willing to lay money that that won't be the case, but that's all right.

MR BANKS: All right. I think that might be a good optimistic note on which to end. Thank you very much for attending today.

MR GINNS: Thank you very much, gentlemen. It was a pleasure.

MR BANKS: We'll now break for just a moment before our next participants, thanks.

MR BANKS: Our next participant is the Australasian Railway Association. Welcome to the hearings. If I could ask you, please, to give your names and position.

MR NYE: Bryan Nye, chief executive officer.

MS RAYNER: Kathryn Rayner, manager, policy.

MR BANKS: Thank you very much for attending the hearings. We have a submission which I think predates the discussion draft and we leave it to you to raise whatever comments in response to the draft or in relation to the earlier submission that you'd like to make.

MR NYE: Thank you, Gary. I thought it might be helpful just to say a little bit about who the ARA is, because we are an organisation that was actually formed around 1894, representing the railway commissioners. It was interesting to hear the previous discussion on wheat. It was formed on competition policy between the railway commissioners to actually prevent competition between the railways, and it actually set prices in their first meeting in 1894. I have all the minutes in my office.

MR WEICKHARDT: Good legal cartel.

MR NYE: It was very interesting. They actually agreed in 1897 to have standard gauge, and we're now trying to get into place some of the things they agreed back in the 1890s, finally into evidence. But the ARA represents the totality of the railway industry in Australia and New Zealand. We not only deal with the freight, we also look after all the public sector and all the people like RailCorp are all full members; the manufacturers of the rolling stock; the totality, including the heritage rail in Australia and New Zealand, so we cover 100 per cent of the whole sector, which is quite unique. And that's quite new. There's been a resurgence of rail and our association was basically closed down last year and reformatted, moved to Canberra and started all again because rail wasn't getting the due recognition as the private sector moved in, so it had to re-get its act together.

We put our submission in and we'll be putting a far more detailed submission with supporting papers in by the end of this week. I've just brought some of the things we do have. We looked through the discussion paper, and some of the issues in the discussion paper we certainly agree with and strongly endorse. One of them was, obviously, the longer-term strategy for the national freight system; the further push of national reform agenda for rail - we support it - and a review of the passenger transport sector and having COAG look at that. They're all issues that we're strongly pushing ourselves.

One of the problems with rail as it's currently structured in Australia, with state governments having the major say in it, is that there's no clear enunciated national transport plan for Australia. It's in between sectors - different sectors, different governments having different views - so if we're going to have a real targeted reform agenda, we really need a single clear vision for the role of transport in Australia, and we desperately need it. Governments pull different policy levers in different ways, and we'll get on to road and rail pricing. Where we're after competitive neutrality, you've got different levers and different mechanisms working. It's very difficult to achieve that when you've got those mechanisms. and we'll provide you with some evidence of that.

We're very encouraged by AusLink, but AusLink really was looking after the intercapital network. In relation to competition policy, when you look at rail, you've got to look at the different sectors. Although AusLink sorted out the intercapital network, we think - and we're doing a lot of work on that - you've got different scenarios. The bit that hasn't really been sorted out, and the next crisis coming up, is going to be regional rail, particularly grain lines, and we'll talk a little bit more about that. Bulk handling, such as coal lines and the iron ore lines, are a totally different scenario to regional rail and to intercapital rail.

In relation to competition policy in every area, you just can't say, "This is the model; this fits the whole scenario," because it just doesn't work that way, and we tend to try to do that. That's why we've got a bit of a mess that we've got currently at the moment. The other thing that's missing, I suppose, is if you look at transport there's no tie-in between the social, environmental and land-use planning overall. We really haven't tied that together, and that's desperately needed. When we talk about the national freight system - a great example - every state government at the current time is trying to promote their port as the port of the future. We've got Brisbane, Newcastle, Sydney, Port Kembla, Fremantle and Port Adelaide - not to miss them - all producing their ports as the port of the future.

What is the national freight movement plan in Australia? Do we need all those ports to be internationally competitive ports? What is the national plan? Without an efficient port at either end of a rail line or an intermodal terminal to get the freight off, we have a mess. We could have a magnificent railway line between Melbourne and Sydney going full speed, going flat out, but if you don't have anywhere to take it either end, or it's the wrong port to take it the other end, we haven't achieved much. An integrated planning process at the national level just hasn't been achieved. AusLink talks a little bit about it, the federal government wants to get into it, but it actually stops at the urban areas. It hasn't tied into terminals, it hasn't tied into ports, and so we really haven't got this national system in place.

If we in rail are going to optimise the delivery of our service, we need a much

clearer, coherent picture. We have some views on it and, we've discussed across other modes the views, but it really needs an intergovernment agreement of what is the long-term future, because freight goes across state borders and state borders really aren't relevant when it comes to moving freight around the country. But we haven't got that message through yet. It's quite clear that hasn't got out there. So that's something that really has to happen then. We'll talk a little bit more about regional freight, but regional freight is certainly a mess.

In our build-up to try to get the money out of the federal government for the first time to invest into rail, which it has done recently in AusLink, with 1.8 billion, we had to prove what was the economic benefit of investment in rail to the economy. We've demonstrated that, if you've got $1 to invest, the return to the economy of investment in a rail line compared to a road, the return is better put into rail, and we'll provide you with that. It's an embargo report that we'll be releasing in February and it's taken a lot of research to actually fundamentally prove what are the economics of rail compared to the economics of road. We'll provide you that. We haven't released it yet, because we're just making sure it's actually watertight, and it has to be watertight if we're going to have a debate with the treasury. We have to prove ourselves.

MR BANKS: Sorry, when will that report be out?

MR NYE: It will be released at the National Press Club in February, but we'll be giving it to you on Friday.

MR BANKS: Do you want us to keep it confidential until that time?

MR NYE: Yes, until we release it, and we're going through a whole process of briefing governments about what's in it on to that period. I suppose on that, then we get onto the different investment. I suppose investment in rail is like the Tattslotto principle: you know, who's got the bid this time gets it, and there's no real cohesive plan across Australia currently. AusLink has addressed that; it's addressed it on this intercapital network from Perth through to Brisbane, and that's where it's kind of stopped. It's just done to the edge of cities, it hasn't gone into the cities anywhere, so we're trying to work through that. The biggest challenge coming to us, I think, is regional grain lines. The reason that rail is still servicing regional grain lines is because we've got community service obligations to continue to do so until 2007. Come 2007, there's a crisis looming.

What happens now is interesting. The AWB uses its monopoly powers within Australia to go to the grain - and there's not many rail companies and they've only got six major operators in Australia; three are the real predominant grain movers - and it says, "You accept that price for moving grain or we're going to put it all onto

trucks." They go to the truckers; exactly the same. They say, "You accept our price for trucks or we'll put it all onto the rail." That's worked. Now that the private sector is there, it's not going to continue to work because they're not going to continue to service grain if they don't get a return on their investment.

So there's been no investment in regional rail, unlike overseas countries where the grain handlers, such as the AWB and GrainCo, are actually investing in the infrastructure themselves. That hasn't happened in Australia and so, come 2007, it's more than likely that the rail industry won't service some of the grain lines if it's not forced to. There is enough money being made on the intercapital freight at the current time and general freight movement. You get a reasonable return on that, so why would you go and service a grain line? The reason you wouldn't service a grain line is because they've got old silos. You've got to sometimes leave a train along an old silo for a day trying to load it, where it really should be loaded in an hour, because there's been no investment in those infrastructures.

When you approach the AWB and others in the grain industry, they say, "Oh, well, we'll just put it on trucks." The truckers will tell you there's a shortage of trucks out there, and the worst margins are made in the grain area, and so they might do it for a year or two, but if we really don't have a whole review of our infrastructure and the way we handle our grain, we're going to have a mess.

MR WEICKHARDT: Who's paying the CSO? Is it the federal government?

MR NYE: State government, and that was part of the privatisation arrangements, but they end in 2007, and you'll see every state government in Australia has made it quite clear that they don't want to fund regional rail. We're trying to work and we're going to provide you the paper. Look, we've got to come up with a solution to this, and it's a solution that might cut across competition. It might have such things as you have along a railway line some super silo sites that are served by trucks to those super silo sites, but we're not going to have railway lines with tiny little silos all the way along or super silos but just all being serviced by trucks. We've got to have a better model and we have to work on that.

Currently the grain industry universally says it's a government problem. That's not what has happened overseas. If you look at what has happened, particularly in Canada and the US, which has got a similar system to us, you've got a lot of local councils. Some of the grain industries along the railway lines have bought the railway line, and you have a vertical integrated model which is quite unique. The grain industry might buy a third of the railway line, the operator might be a third and the local councils might be a third. They operate in a different way. We've got to establish a new model for Australia for the grain industry or we're not going to have a boom in grain. I don't think that has come to people's attention dramatically,

because they just think business will continue as normal. Well, it won't.

MR WEICKHARDT: I saw a quote recently saying that in New South Wales grain lines recover 7 per cent of the operating costs. Is that correct? I mean, it seems an extraordinarily low number.

MS RAYNER: I don't know what the figure is, but it would be exceptionally low because there is no capacity to invest in those tracks based on what is charged by access fees.

MR WEICKHARDT: But if there were investment and all these sorts of deficiencies were covered on big grain routes, do you think rail can be competitive?

MR NYE: Without a doubt. I mean, it would be a combination of truck and rail.

MR WEICKHARDT: Okay.

MR NYE: It will all depend on the whole change in the grain network and rail. I mean, one of the major things we are trying to move forward on with the federal government now is a feasibility study for a Melbourne to Brisbane rail line, going inland because of the problems along the coastal route. Certainly, in New South Wales that will change the configuration of the grain lines. People tend to focus on New South Wales grain lines, but the worst problem is in the Eyre Peninsula. Western Australia follows that up, then New South Wales third and Victoria is fourth. Queensland has got quite a mature rail system, and the grain industry is not a particularly great producer.

Rail will be part of the solution, but it's got to be done in a way that there is going to be road-rail, and we need a logistic supply solution. It might require a review of competition policy in certain areas. It's not going to be road versus rail, because that won't satisfy the market out there. You won't invest in that way, so we really have to look at a new model. I don't have the solution, but I think we really have to come up and start investigating that model, because that's the next crisis in the logistics industry; regional infrastructure and regional freight transport.

MR BANKS: If the ACCC were here, as they were yesterday, they would say the authorisation provisions of the act would allow such arrangements to occur.

MR NYE: Yes, we would, but we've got to come up with our own internal model and it has to be something that I think the grain industry has to buy into. They haven't shown a willingness to do that yet. They think it's a government problem and, you know, there's a new dynamic out there. The private sector now runs the railway lines.

Just moving along, there are multiple access regimes because there are multiple owners of rail around Australia. We have to rationalise that. It is probably within the purview of ourselves within the association to pull that together; to have a national track access regime. I'm not talking about single desk but a commonality about the way we get track access. We don't believe we need - because they're all our members - all the CEOs to sit around the board. We probably can sort that out ourselves. But we'd need to rationalise that. The ARTC took over the lease of New South Wales but in the Hunter Valley, from the coalmines to the port, you've got three different access regimes, even though ARTC took over the lease. There is still some of it on the rail infrastructure corporation. Some of it is on RailCorp lines.

So they have got three access regimes where they previously had one. We've got to sort that out, and it's within our purview to do that. We're making it hard for ourselves. That's something I think we can do.

MR WEICKHARDT: When you say "we can sort that out" - - -

MR NYE: The industry itself.

MR WEICKHARDT: The industry.

MS RAYNER: There are probably two aspects of that. There is the coordination between track managers which is what we can do. There is the issue of state based access regimes, and that's a concern because of the fear of ongoing divergence and then the flow-on effects that has on pricing and access. We would certainly like to see more of a national approach to that. At the moment, we have two states doing separate and independent reviews of their access regimes. We don't know where that will go. So I think there is scope for a more coordinated approach to that aspect.

MR BANKS: Did you support that finding in the review of the value of having more national coordination?

MS RAYNER: Absolutely, yes. The problem with the increasing divergence is what that means for the industry in terms of costs and the admin costs. Some of the extraordinary paperwork that's involved to satisfy a state regime can be quite administratively costly. I mean, just re-tabulating the way you list your rolling stock and things like this. There's no justification for that sort of divergence.

MR NYE: There were a whole lot of state based silos in Australia. Trying to overcome those silos' administration and everything into a national system; it's only been in the last 10 years they're actually moving forward in that way. It's quite a challenge. There is a big debate between the way that rail is priced and road is

priced. I'd offer this, because we'd actually looked at some of your questions previously, trying to understand some of them. I want Kathryn to go through this. We tried to make it simpler, because we looked at some of the previous submissions and some of the questions were making it quite complex, so I'd like Kathryn to go through this.

MR BANKS: I wonder if you could just briefly repeat for the record what you said then because you left the microphone - - -

MR NYE: Okay. We've looked through some of the submissions that went previously and that had been published and some of the questions you've had, just trying to understand the difference between road and rail pricing. We thought it might help a little if we actually simplified it and put it in a table to show you the different bases that went through there. I'll ask Kathryn to go through that, because we've tried to make it easier to understand what the two different bases are.

MR BANKS: Good. And this will be part of your submission that's coming to us soon?

MR NYE: Yes, it will.

MR BANKS: Fine. Thank you.

MS RAYNER: The reason why we have such a concern about road pricing is the impact it has on the rail industry's capacity to invest and to grow the industry. Road pricing, essentially, is based on recovering the costs for capital and maintenance - it looks at the past two years and the budgeted forward year - compared to rail, which is looking at trying to recover your full economic costs, including depreciation rates of return. Road recovery assumes that the asset is written off in the year that the expenditure occurs. There's no depreciation. There are no rates of return. Also there is concern about all the inputs that go into road pricing. It's based on surveying local governments. It's based on ABS road surveys. I think the National Transport Commission itself recognises that the inputs are not 100 per cent accurate.

In terms of the heavy vehicles, which is 4.5 tonnes - they're the vehicles that are directly competing against us - only 21 per cent of road costs are allocated to heavy vehicles. Within heavy vehicles, there is cross-subsidisation within the sector. The B-doubles, the road trains, are only cost-recovered about 80 to 90 per cent of the costs that are deemed to be appropriate to recover. We would suggest the costs that are deemed to be appropriate to recover are underestimated in the first place.

MR BANKS: So the cost base is underestimated and the proportion attributable to the heavier trucks is also underestimated?

MS RAYNER: Under-recovered, yes.

MR BANKS: Under-recovered.

MS RAYNER: Yes. That is documented in BTRE research into land transport. We've also done our own research, which is quite consistent with that. There is also no capacity for mass distance charging for trucking, and I suppose that's the biggest issue. Rail does charge for mass distance charging. There is a tendency to use the fuel excise as a distance charge, but it doesn't particularly work in the sense that the more efficient trucks are more fuel efficient. So it almost distorts the distance charging into the smaller trucks subsidising the larger trucks, which are those that compete against us, and externalities are not factored in at all.

What that means for rail really is, in terms of where we can peg our pricing, we're price-taker against road. That means we can't price for our full economic costs, which impacts on our capacity to invest. That's, I think, the issue that is not fully understood by those people that are setting road pricing, and there's no cross-modal analysis of the impacts on rail of how road pricing is determined and what that means for us.

MR WEICKHARDT: The third assessment that - - -

MS RAYNER: The third heavy vehicle determination, which they're working on now.

MR WEICKHARDT: Yes. Is that likely to fundamentally relook at the basis of recovering the road charges or is it simply going to work on the existing basis, do you think?

MS RAYNER: It's been quite disappointing. While transport ministers agreed a set of pricing principles that gave the NTC the capacity to look at mass distance charging and look at externalities, they are not doing that, on the basis that they've determined that it's too complex. So the third heavy vehicle determination will see really just an updating pretty much against the existing principles. They will look at the internal distortions within the trucking sector to try and address that, but the changes will be quite minimal. We have asked them to look at the competitive neutrality issues associated with the road pricing, but I suspect that will use the current assumptions that they've made about what is the appropriate amount of cost recovery.

MR WEICKHARDT: Do you accept the point that we make in the draft report that, in looking at this whole area of freight, competitive neutrality between modes is

important and that should include coastal shipping as well?

MS RAYNER: Yes, we certainly do believe it should involve coastal shipping. The impact of the increasing use of SVPs, particularly on the east-west route, is having an impact on our capacity to grow modal share, not so much on the east coast but certainly east-west. So the whole cabotage issue should be factored in, yes.

MR WEICKHARDT: Okay. Thank you.

MR BANKS: So you're worried that coastal shipping is growing too fast?

MS RAYNER: It's not necessarily a bad thing that it grows. The issue is that there isn't really competitive neutrality with overseas ships, with different environments coming in just using marginal costs to pick up easy freight, basically. I mean, they're not really committed to the Australian freight system. It's easy freight at marginal costs, so we can't compete as at - - -

MR NYE: When you look at coastal shipping in the east-coast corridor, where most of it goes to Melbourne, Sydney and Brisbane, only 17 per cent of the freight goes by rail. If you think of it in the geography of Australia, it is bizarre that that's the case.

MR BANKS: But the lion's share goes by road, doesn't it?

MR NYE: By road, yes.

MR BANKS: 70 per cent or more?

MR NYE: More than that, yes. Only about 2 per cent goes by shipping, so we've got these iron highways just going up and down, moving more. Is that sustainable? That's a question that we need to go forward. We thought that matrix helps, because everybody asks, "What is the real difference?"

MR BANKS: Yes. It's pretty useful.

MR NYE: The sorts of things that aren't is the social environment outcomes, the difference between the different transport sectors. I think one of the benefits we don't see for those that invest in rail is that, when you look at the environmental benefits - relieving road congestion, the difference in accident costs - all of those things just aren't factored into the investment decisions, because there's nothing coming out of it.

A good example, I suppose, is the cost of accidents. The cost of accidents to

the national health bill is really not looked at in transport, but if you just look at some of the figures - and we just pulled these out and put them in our submission; these are from the ATSB, the Australian Transport Safety Bureau, figures from 1925 to 2002 - 169,458 people died as a result of road fatalities compared to 189 for rail fatalities in that same time. The same figures from 1996 - estimated, 1996 Australia's road accident costs were in the order of 15 billion compared to rail accident costs of 196 million. So the impact that that actually has on the national health bill is never figured into when you're actually making those investment decisions.

It's exactly the same with greenhouse gases. One train from Melbourne to Sydney takes 150 trucks off the roads, saves 44,000 litres of fuel and is nine times more energy efficient. We've never kind of moved those and put those quantum figures together to actually start demonstrating some of the benefits of rail, and that's what we're trying to do. But when you're making investment decisions, the person making the investment in rail doesn't see those investment decisions. That's a government decision, why it should be focusing on other issues. So they're quite interesting. Moving on for the national reform agenda for rail - - -

MR BANKS: Sorry, just on the implication of that, in a sense are you arguing there's a kind of CSO implication coming out of those broader public good dimensions of rail or are you saying that, in a sense, the negative should be taxed in relation to the competing - - -

MR NYE: If you're going to look at pricing and competitive neutrality and include the externalities in, which we believe you should be looking at, then there should be some - and how you do it conservatively - I mean, there are all sorts of models around the world to do that and certain countries do have externalities use. We don't use them in Australia, yet we think we should. You really should have them looked at.

MS RAYNER: It should also be factored into the investment decisions cross-modally. I mean, at the moment you tend to factor in a small percentage for externality for rail investments, but it's not taken into account in terms of cross-modal investments. I understand AusLink methodology is looking at that, but then again that's only part of the national transport network.

MR BANKS: Okay.

MR NYE: Moving on to the national reform agenda, which you say should be encouraged, we're totally trying to do that. One of the biggest issues we've got now is the co-regulatory reform agenda for rail safety. We have seven rail safety regulators in Australia for 20 million people; the US has one for 220 million people. Trying to change that is - you know, I'll be bald or grey by the time I get to this, but

it's just personalities. It's interesting, section 98 of the Constitution gives the federal government authority over rail, but it's never been used, never been enforced - - -

MR WEICKHARDT: It seems such a no-brainer that it should be fixed - - -

MR NYE: It might be a no-brainer, but you try and change it. I tell you, I spend hours trying to go through this and everybody agrees. All the state ministers say, "Yes, yes, yes." The two big states say, "Yes, we agree on a national reform agenda, as long as it's done the way we want it." It's beating your head against a brick wall.

MR WEICKHARDT: Has this ever got up to a COAG level and a debate?

MR NYE: Not to COAG. It's gone to ATC and it's never got out of that environment. I mean, safety is just one issue; then you go to railway communications. The train that leaves Sydney to go across to Perth, the Indian Pacific, has 345 kilograms of radio equipment in it, eight different radio sets to go across the country - radio - no digital set. Trains can't talk to each other still. We're trying to do something about that; we're very close to agreeing a new protocol. We're so far behind that we take a quantum leap forward and, again, we're going to miss a whole generation of communications, but that's just driving down and that's part of our micro-economic reform agenda. We've got to keep doing those.

They've agreed recently on a one-coloured safety vest. That's all we've achieved in 10 years. But that's true. That's the type of thing we're trying to battle with, and that just comes out of the historic way that rail was - you know, Federation and the way state governments set up railways, and we've got to overcome that. So the more that COAG and more that government can try and focus on the regulatory reform agenda for rail, it's just crucially important, otherwise we just won't get an efficient railway system. So we're pursuing all of that.

MR BANKS: In relation to the safety regulation and the disparity there - I must have misunderstood - I thought things were on track, so to speak, to have that addressed.

MR NYE: There are things on track, and I don't want to be seen to be at all negative, but you'd think we'd have an agreement to have one national safety regulator. Well, we can't. We're agreeing that maybe we've had a model legislation implemented in each of the seven states. We've recently gone through that and we agreed to have national health guidelines, and Victoria put them up. They were agreed as the national model across the states. Victoria then implemented them through their own parliament, amended their own national health guidelines in a different way. So we're not keen on model legislation across states, because states implement it totally differently. We strongly argued the case that we should have

one national rail safety regulator, but we probably will end up with model legislation and then we'll continue to pursue that until eventually we get to the commonsense agenda, but it's a challenge.

We're trying to do away with seven safety regulators who advise their ministers of how important they are, and I'm not their champion because I'm trying to do them all out of a job. So they're fighting every step of the way - and I understand that - but I'm just going to pursue that. There's a whole series of others - you know, the regulatory costs - inconsistencies between the states. We're trying to get national approaches in all of that, and that's an ongoing agenda issue. But I think we're making progress, ever so slowly. When it gets to passenger transport, we agree a multimodal approach to that. We've just formed an alliance with the Bus Industry Confederation and the International Public Transport Association, UITP, to try and pull together things in Australia. A great example: in Europe, 23 countries speaking different languages, they have one common drivers' licence. We have seven states in Australia, and we've just got an agreement we can have common core competencies for train drivers.

This has all been in the last 12 months, so they're the types of things that we're trying to do. With the size of the system in Australia, why do we need different rail carriages and passenger carriages in each state? Surely, we can have a commonality of approach, commonality of ticketing systems, commonality of all of those. The commonality of the federal government is not involved in urban transport at the current time, but eventually we believe it should do. Such things as the bizarreness of the fringe benefits tax encouraging people to drive their motor vehicle beyond - you know, they get a benefit beyond 25,000 kilometres a year. You compare that if you, as a company, then provide somebody with - you don't get any benefit as a company if you provide people with passenger transport to and from work. You don't get the same benefit. And the federal government has it within their ability to do some of those things.

So we think there are ways that we can get a better approach to public transport, but we've actually got to put a case together and that hasn't been argued well yet. So we're working on that. When you get to passenger transport, I go back to where we really first started from, where you can have a magnificent intercapital network and regional rail network, but you've got to get through the cities to the ports. For the federal government to say it doesn't want to become involved in urban planning is a bit naive, because the congestion is going to destroy the economies in the cities. We need a national transport system to actually alleviate it. If you're going to move freight through, if it's going to be congested by people and passengers, we need a different approach to all of that. So we're after that kind of national approach.

Your recommendations we will be strongly supporting and, if anything, there's no rail reform fatigue. I mean, we've got a massive amount of reform to occur to make ourselves efficient and a lot of it is internal and a lot of it is getting out of the state based systems. If it doesn't happen and we don't accelerate it, then the whole national transport system of Australia will suffer.

MR BANKS: Good. Okay. We probably don't have a lot of questions, because I think we find ourselves in agreement; a refreshing change. What it comes down to, I think, perhaps is inertia or fragmentation dealing with the legacy of a very fragmented system that is still dogging reform rather than, in a sense, not knowing what to do.

MR NYE: Look, rail hasn't sold itself. I mean, it never got its act together, to be quite blunt. It never kind of pulled itself together. It never focused itself. It has just been doing that in the last 18 months. It has never gone to governments and said, "This is the economic benefit of rail." As you all know, you've got to convince the finances and the treasuries right throughout Australia of the benefit of investment, and it has never done that. It's doing that now and it has to do a lot of catching up very quickly, but it needs governments to work together in a cohesive way and that's why we're encouraging your report. It needs to be elevated to incredibly important. I'm not from the rail industry but, when you look at the size of Australia and you look at the way rail is used in Canada, the US and around Europe, we are a very poor user of that system in Australia, yet our geography would demonstrate we should use it better than anybody else. But we don't.

MR BANKS: Thank you very much, and more power to your elbow.

MR BANKS: Our next participant is from the Australian Friendly Societies Pharmacies Association. Welcome to the hearings. Could I ask you, please, to give your name and your position.

MS COLLINS: The name is Betty Collins and I'm the executive director with the Australian Friendly Society Pharmacies Association.

MR BANKS: Thank you very much for attending today and also for the submission that you provided back in June, which was helpful while we were preparing our draft report. As we discussed, perhaps you might like to just go through some of the key points that you want to make.

MS COLLINS: Thank you very much for the opportunity to just speak to you briefly. Yes, we have provided the submission and my association fully appreciates that this is not the forum to be readvocating our position on competition principles. The purpose of the submission was primarily to provide this inquiry with a case study of an industry - the community pharmacy industry - that, in our opinion, requires significant reform and the advent of the development of the competition principles and the agreements signed up to by the governments forming that package was really, historically, the first opportunity for the community pharmacy industry to be reviewed to see how it was operating and, particularly, to look at the anticompetitive restrictions that operate in that industry and have done for a long time.

We thought that it would be, as a case study, a real opportunity for you to see how the political process intervened to turn around what, in our opinion - the proposed reforms - were, in fact, extremely modest. Having said that, I'd like just briefly to give you a little thumbnail sketch of the history of Friendly Society Pharmacies. Friendly Societies formed or developed their dispensary movement starting in 1847. That's a long time ago and it's not a mistake, 1847.

MR BANKS: I think you've just trumped the two proceeding participants too.

MS COLLINS: Right. The purpose for Friendly Societies in developing their own dispensary movement at that time was a reaction and a solution to the high prices for drugs and medicines that were being charged and able to be charged by what we describe as the commercial chemists of that time. Friendly Society members largely got both their medical services and their medicines through the lodge system, through their membership of the various lodges, and they paid their weekly membership fee to their lodge and that entitled them to access the lodge doctor and then they would go the commercial chemist for their medicines. That was a problem that was identified as far back then; that the medicines for the very poor and the working class people were too expensive.

Right from the very beginning, my members historically have literally been in competition with the for-profit chemists that are today called pharmacists, and that hasn't changed. The dispensary movement grew very rapidly. By the 1940s, it's estimated that probably more than 50 per cent of Australians were getting their medicines through the Friendly Society dispensary movement, so there was real competition. Our Friendly Societies today continue to be as they always have been. They are membership based and they are not for profit. That is in contrast to the other model, which is a for-profit model.

The restrictions that were applied to Friendly Society dispensaries started to be applied in the mid-1940s and what had happened at that point in time was just directly before the Second World War. The big commercial pharmacy chain from England called Boots had quite big plans to move to Australia and roll out - that's a modern word - their model of chain pharmacy stores in Australia. That was of significant concern to the Pharmacy Guild members at the time, naturally, and it was not difficult at all for the Pharmacy Guild to persuade the various state governments to introduce restrictions in the pharmacy industry that would prevent that happening. That was the first time that legislative provisions over the ownership of pharmacies were introduced into Australia.

To prevent the chain concept and to prevent overseas interest, the first restrictions were to restrict ownership of pharmacies to pharmacists only and to restrict the number of pharmacies that each pharmacist could own. So those restrictions were introduced in all of the states at various times and in different ways. We've heard that earlier today too. No government did it quite the same way. Those restrictions were introduced in the 40s. At the time, they didn't affect Friendly Society dispensaries, but the Pharmacy Guild continued to press governments to close down the Friendly Society dispensary movement, and there was quite a battle in the 50s over that.

The next major development was the introduction by the Commonwealth of the Pharmaceutical Benefits Scheme and that, of course, had an enormous effect on the community pharmacy industry, because for the first time prescription medicines were going to be provided to the community at a subsidised rate. That encouraged the Pharmacy Guild to persuade governments to look again at the role of Friendly Society dispensaries as a result of the subsidised medicine program, on the argument that the not-for-profit sector in the pharmacy industry was now no longer required. That was back in 52.

Eventually, that happened and again there was a round of restrictive provisions by all of the governments. Effectively, those restrictions resulted, generally speaking, in Friendly Societies not being permitted to grow any further. They were

restricted in their location. For example, in 1945 every dispensary in New South Wales was restricted to a radius of one and a half kilometres of the premises that they occupied. There were approximately 55 Friendly Society dispensaries in New South Wales at that time. By today, there are only eight surviving pharmacies, and they still occupy the premises that they occupied in 1945. One new interstate Friendly Society was able to open a single pharmacy in New South Wales, so that's the only new pharmacy since 1945.

There were other restrictive and anticompetitive measures but, to move on, that largely is the situation that has been in place since 1964, when the last major restriction the Commonwealth government promoted was to prohibit a Friendly Society from discounting the co-contribution payment. Up until 1964, Friendly Societies had always provided a discounted co-contribution payment, and that was seen by the Pharmacy Guild as being anticompetitive to their members. They could have done the same thing, but - discounting of the PBS co-contribution payment - that's the history of that prohibition.

That has been the situation from that time right through till the introduction of the competition principles, which gave for the first time the opportunity for the Friendly Society pharmacy movement to have all of these restrictive provisions reviewed. In the submission that we made to you, that brought you up to date as to how the implementation process of the review outcomes got derailed. The development since then, following the New South Wales template, if I can call it that - I think that's what the Prime Minister called it - the Prime Minister's solution to the Pharmacy Guild's claims was to advise New South Wales that, if it increased the number of pharmacies allowed to be owned by a pharmacist from three to five, restricted Friendly Societies to a maximum of six pharmacies per society, then they wouldn't suffer any loss of competition payments.

That's the legislation that was subsequently introduced into New South Wales, but what it did do, unfortunately, was leave in place the old restrictions that have been there since 1945. So one member in New South Wales - and it's a member that has owned six pharmacies since the 1920s; its six pharmacies are restricted to that radius of the premises that it occupied - in the last 50 years, because it has been unable to grow, unable to relocate following its membership base, unable to open a new pharmacy in another growing location, et cetera. Its position is quite parlous. It has been hanging on for this review process, which for pharmacies started in 1998, but that restriction was maintained.

In Victoria at that time Friendly Societies were unrestricted, so they're quite vigorous and quite vibrant in Victoria because they've been able to grow or not grow, according to their membership, et cetera. They've been unrestricted in Victoria. The Prime Minister's advice to Victoria was that Friendly Societies in Victoria that

owned more than six, of which there were five, be grandfathered and put on the shelf; that they not be allowed to grow any further. If they closed or sold a pharmacy, they couldn't replace it; the old grandfathering provisions. Those societies that owned less than six could grow to six. There are probably about five societies that own one or two. They're exactly the societies that are not going to grow, because they're wedded to their local community - their rural or regional community - and that's where they've been for over a hundred years. Wonthaggi is suddenly not going to move to Ballarat or Bendigo.

Victoria found that a very difficult solution for them, so the outcome has been a compromise. Legislation has now been enacted in Victoria - it came into effect three weeks ago - and it provides that a pharmacist can own up to five and the Friendly Societies that own less than six can grow to six and those Friendly Societies that own more than six can, during the next four years, increase by 30 per cent of the number of pharmacies that they owned on the day the legislation came into effect. In Victoria, which was in fact put forward by the Wilkinson review by COAG as the model for pharmacy legislation elsewhere in Australia, that in fact now has been turned on its head and new restrictions have been put in place.

In Tasmania, the legislation there went through both houses of parliament a fortnight ago but it hasn't yet been enacted. In Tasmania, any Friendly Society is permitted to own a pharmacy but it is restricted to a maximum of two and a pharmacist is restricted to two. The new legislation increases those numbers from two to four and it introduces a new restriction on Friendly Societies so that, when the legislation is enacted, the only Friendly Societies allowed to own a pharmacy in Tasmania will be the three existing ones. One is in Launceston, one is in Queenstown and one is in Hobart, so you can see that there's not much growth factor there.

In the Northern Territory, there were no restrictions on either pharmacists or Friendly Societies, but the Northern Territory government introduced legislation that restricted the ownership to pharmacists only. It also included a provision that a Friendly Society could be permitted to own a pharmacy with ministerial approval and that approval could only be given in special circumstances. That's the type of restriction that has operated in Queensland, New South Wales and Western Australia since the 60s. Our experience is that, in all of those states, the Friendly Societies have only succeeded in getting ministerial approval twice in 60 years, so we're not very confident that we'll actually get approval to open a pharmacy in the Northern Territory.

In the ACT, it's the reverse. The government in the ACT had tabled a bill in August that would have amended the Pharmacy Act to permit Friendly Societies into the ACT. The Prime Minister advised the ACT government that their competition

payments wouldn't be affected if they didn't proceed with that bill. So up until 2001 - this is a debatable point, but it has emerged as a result of the Wilkinson review - against popular belief, strictly speaking Friendly Societies would have been permitted in each of the territories, but we didn't know that. As soon as that was made known - that that is, in fact, how the legislation in the territories operated - the Pharmacy Guild mounted a very successful campaign to persuade both those governments to amend their legislation in a manner that blocked what the Pharmacy Guild claimed was a loophole.

So Friendly Societies got written out of the ACT legislation by clever definition of the ownership arrangements. Because Friendly Societies are corporations under the Corporations Law, the directors of each Friendly Society are required to be elected by the membership at an AGM in the usual manner. A company in the ACT permitted to own a pharmacy can only be a company of which all of the directors are pharmacists or pharmacists' relations. So the ACT government did not proceed with the bill and it lapsed when the assembly dissolved prior to the election six weeks ago.

That brings you up to date on the legislative change. In Western Australia, Friendly Societies are restricted to the one Friendly Society that currently owns one pharmacy and that pharmacy is restricted to the premises it occupied in 1969. If that pharmacy needed to relocate, it couldn't and it would then have to close, and under the current legislation a new one can't be opened. The WA government hasn't made its position known yet.

In South Australia, two Friendly Societies, as named in the legislation, are allowed to own pharmacies. The Mount Gambier Friendly Society owns one pharmacy in Mount Gambier and a large Friendly Society in Adelaide. Its trading name is National Pharmacies. Under that legislation, it is permitted to own 31 pharmacies in South Australia. It has owned 31 since the 60s. Earlier than that, it was restricted to 26, and that was increased in the 60s to 31, but that's where it's set. The South Australian government's position hasn't been made known. It is understood that the Prime Minister has written suggesting that the sixth scenario be adopted, but that doesn't suit the South Australian situation.

That brings you up to date. In summary, the Friendly Societies Pharmacies Association went into the review process anticipating the opportunity to be able to identify the restrictive provisions against its members within the community pharmacy industry and to seek some relief from those restrictive provisions. As a result, we've actually come out of it with more restrictions.

MR BANKS: To what do you attribute that?

MS COLLINS: The sheer political lobbying power of a powerful organisation, the Pharmacy Guild of Australia. It's important to understand that the Pharmacy Guild's role and its organisation - it is not representative of the pharmacy industry per se, it represents the owners of pharmacies. It's an employer organisation.

MR BANKS: Of which there are a large number, however.

MS COLLINS: Because of the control on the total number of pharmacies allowed at any given time in Australia under the Commonwealth provision through the agreement process with the Pharmacy Guild, the total number of pharmacies is approximately 4800. Multiple ownership occurs. That is one of the difficulties with the number provision and, as all of the reviews have demonstrated, enterprising pharmacists have always been able to find a way around the number rule. Pharmacy boards in all their submissions to the Wilkinson review acknowledged that and acknowledged the fact that they weren't able to control that part of the legislation.

MR WEICKHARDT: How do they do that?

MS COLLINS: They do it in a variety of ways. For example, they can split the business into what in the trade is called "front of shop, back of shop" and split the ownership between spouses and other pharmacists in partnership arrangements. They can go into management arrangements whereby a pharmacist might on paper be the owner but, in fact, the business is managed and controlled by a management company. They're popular devices.

The pharmaceutical wholesalers have been very active in assisting and providing financials and that to get some economies into the industry. If there's a total of 4800 pharmacies, theoretically, that's the maximum of the Pharmacy Guild's membership. The profession of pharmacy, that's the Pharmaceutical Society of Australia and that's the professional body that both owner pharmacists and employee pharmacists belong to. The number of employee pharmacists is approximately 15,000. They're not represented by the Pharmacy Guild, they're represented by the PSA. How did we come to this position? The Pharmacy Guild is passionate about their belief of the principles that, to be safe and for the best benefit to the public, that can only guaranteed if pharmacy is owned by the professional pharmacist.

To us, that's a bit like a motherhood statement. The existence of Friendly Societies and their proven demonstrable ability to run excellent, safe, quality pharmacies is the evidence that it's not just the professional that can do that. The community have the highest regard for pharmacists and pharmacy and rightly so. That's an esteem and regard that the Pharmacy Guild very cleverly harnessed and, for the competition principles, it equated competition being bad. Competition principles are causing the deregulation of the pharmacy industry. Interpretation: that means

supermarkets will be able to run pharmacies.

MR BANKS: Dispense.

MS COLLINS: It was the jump in the language that they used, so "modest reform" was equated with "total deregulation"; the concept that you're 100 per cent assured, if the pharmacist owns the business, nothing will go wrong. If a corporation owns the business, you are guaranteed it will be greedy, unethical and cheat you. We all know being qualified and being a professional is not an inoculation against potential bad behaviour. It happens. They also - - -

MR BANKS: Just on that, your organisation represents, I suppose, Friendly Societies who couldn't be regarded as avaricious profit-seekers by definition.

MS COLLINS: Because my members are not for profit.

MR BANKS: That's true.

MS COLLINS: Yes.

MR BANKS: So why did they, in a sense, suffer from this lobby against the for-profit sector outside of ownership by pharmacists?

MS COLLINS: For example, when the Pharmacy Guild mounted its petition - the famous petition in New South Wales where it collected half a million signatures - it used words like "corporatisation", "deregulation" and the destruction of the community pharmacy industry when it was really code for Friendly Societies, because the New South Wales legislation only proposed to remove the old restrictions against Friendly Societies and to allow pharmacists to own an unlimited number of pharmacies. They were the only two provisions, but that was lost in the noise of the campaign and the language that was used.

MR WEICKHARDT: So it was a campaign at local member levels, local politician levels or - - -

MS COLLINS: Yes. Media, local level, et cetera. The Pharmacy Guild is probably one of the most well-resourced representative groups existing in Australia today. It gains significant power and resources as a result of the Guild Government Agreement, as it's referred to. There are two parts to the agreement. One part is the remuneration that the Commonwealth government pays to a pharmacy owner for the service of dispensing a government-subsidised drug. That figure is very very significant.

MR BANKS: If you hand it to us and then just speak back into the microphone, thanks - - -

MS COLLINS: That figure that is paid to the pharmacist owner on a prescription basis is negotiated by the Pharmacy Guild and, as part of that agreement process, in each agreement the Guild agrees to a savings formula to help the government manage the total cost of the Pharmaceutical Benefits Scheme. In return for that, the government provides some $400-odd million over the life of the five-year agreement for a range of programs in the community pharmacy industry to assist the industry to improve its quality. Largely, that money is paid directly to the Pharmacy Guild of Australia and it's the Pharmacy Guild that manages the programs, not the government.

That gives it significant resources and influence. It also receives outright an amount - say, currently of the third agreement, which is due to expire in June 2005 - a total amount of $7.1 million, which is an administration fee that is able to be expended by the guild to assist in its administrative processes. That's separate from the moneys that it manages for the funding of the various programs, such as the rural workforce, the rural pharmacy industries, so pharmacists are eligible for grants and what have you if they relocate or open in a rural regional area. There's complicated criteria, but it's the Pharmacy Guild that manages that. It assesses the criteria, it assesses the applications and it pays it out.

The Quality Care Pharmacy Program is also funded under the agreement process and that is also managed by the Pharmacy Guild. In a long way around, answering the question as to how did we get there, it's totally unequal resources. The Friendly Society Pharmacy Association is extremely small. There were only 33 Friendly Societies that owned pharmacies in Australia at the time of that report. Two in the last three months have found it just too hard, so they have sold or closed their pharmacies down, so that reduces the total number to 31. My association's resources extend to 31 members and their executive director, who they pay on a part-time basis.

MR BANKS: Okay. I see the problem. Perhaps if we get to the bottom line in terms of our own review, do you therefore endorse the notion of at least reviewing these regulations sooner rather than later? We also mentioned the possibility of the 2005 review of the Australian Community Pharmacy Agreement as another opportunity for such a review.

MS COLLINS: Yes. My association's position on your recommendations is strong endorsement, particularly of the recommendation that pharmacy be part of a second round, sooner rather than later. We would recommend that that recommendation actually be strengthened. We also strongly support your views for a better

community and public education program to make the community more aware of the real issues of competition policy - the positives not the negatives - that you discussed early in your report, again, as a case study with the community pharmacy industry. We think that that's an example of where the community didn't properly understand, and that was able to be taken advantage of by describing situations. As I said, what in reality were modest reforms became, in the public face, deregulation and the destruction of the industry; that was exaggeration, but a better understanding of the benefits to the community.

Lastly on that, the public interest test is extremely important. Again, generally the community is not fully aware of the importance of the public benefit test and criteria which things can be measured against, and that change is not just for change's sake and a fundamentalist-driven philosophy. So we strongly support your recommendations sooner rather than later, and we would like to see that perhaps emphasised - strengthened - given the reality, though. Lastly, perhaps not as part of the agreement process - I'm not quite sure how that could operate - because that is strictly between the Pharmacy Guild and the Commonwealth government. No other stakeholders participate in that process at all.

MR BANKS: No-one else participates in the review.

MS COLLINS: In the negotiations that lead to the agreement - - -

MR BANKS: I see.

MS COLLINS: - - - there are no other stakeholders, and the legislation - the National Health Act - doesn't allow other stakeholders.

MR BANKS: If that's right, it doesn't look too promising as a forum for such a review then.

MS COLLINS: Moving to your next recommendation that consideration be given generally to health being reviewed and that that would be a second opportunity to include pharmacy again, because it is an integral and absolutely pivotal part of the overall health industry, we would support that as well, naturally, but I would suspect if it was picked up and accepted by governments, again, it would be further down the track.

MR BANKS: Good, thank you. Thank you very much for that. It was very informative. We'll you break just for one minute, before our next participants.

MR BANKS: Our next participants are from the Insurance Council of Australia and the Insurance Australia Group. Welcome to the hearings. I'll just ask you, please, to give your names and the capacity in which you're here today.

MR BOOTH: Yes, my name is Dallas Booth. I'm the deputy chief executive of the Insurance Council of Australia.

MR PEARCE: My name is Douglas Pearce. I am group executive for insurance strategy for Insurance Australia Group.

MR LEVER: My name is Mark Lever. I'm national product manager with the compulsory third party division responsible for the directed intermediary distribution of compulsory third party.

MR BANKS: Good, thank you. Thanks very much for attending this morning. We've got a submission from each organisation, but no formal submission yet on the discussion draft. Is that right?

MR BOOTH: I think that's right.

MR BANKS: Okay. So we're happy to have your comments here. Were you proposing to put a written submission in?

MR BOOTH: We certainly will.

MR BANKS: Okay. Thank you.

MR BOOTH: If I could make an opening statement, firstly, I need to disclose that I am a member of the WorkCover Board of Tasmania and I am not here in any capacity at all on behalf of the WorkCover Board of Tasmania or the Tasmanian government. I'm very much here today on behalf of ICA and the general insurance industry.

ICA is the representative body of general insurance in Australia. Members account for over 90 per cent of total premium income written by private sector general insurers. Our members are both insurance and reinsurance companies and they form a significant part of the overall financial services system and the provision of financial security to Australians and Australian business. Recently published statistics from APRA show that private sector insurance generates virtually $35 billion per annum in gross premium revenue and that the industry has assets of approximately $61 million. The industry employs, we think, about 30,000 people.

I would like to do three things briefly in these opening remarks: firstly, talk

about competition policy in the context of insurance and how ICA has seen a marked lack of progress in that area; we would like to talk briefly about the role of competitive neutrality, particularly in statutory classes of insurance; and we would like to make a couple of comments on specific elements of the interim report and make two recommendations to the commission.

Firstly, talking about insurance and NCP generally, in spite of a decade of NCP in Australia now, there has been very little progress in general insurance markets. As noted by the recent competition council report, public sector intervention in premium-setting processes is commonplace and serves to distort the incentives that risk based pricing creates. In New South Wales and Victoria, workers compensation has been an entrenchment of public monopolies rather than a move towards a more competitively neutral market basis.

Despite the lack of reform, there have been few formal findings by the competition council and, even where blatant breaches have occurred such as when planned privatisation of New South Wales workers compensation was first deferred and then later cancelled without any formal NCP review, there have been no negative consequences to date.

ICA's initial submission to the inquiry emphasised the opportunity that presents itself for meaningful reform under the NCP agenda through the promotion of effective competitive neutrality and the removal of anticompetitive restrictions, particularly in the areas of statutory classes of insurance. At the same time, ICA also recommended that broader micro-economic reform should be initiated, vis-a-vis recognition of the Australian Prudential Regulation Authority, as the sole prudential regulator of general insurance, and the abolition of state and territory taxes, these recommendations also being consistent with the findings of the HIH Royal Commission.

In responding now to the content and recommendations of the interim report, ICA wishes to focus on two main areas: firstly, the need for competitive neutrality to be applied to government business enterprises operating statutory classes of insurance where they are not already doing so and, consistent with the recommendations of the HIH Royal Commission and the Productivity Commission's own inquiry into workers compensation, a national program aimed at increasing consistency across major jurisdictions in key areas of statutory classes of insurance, particularly workers comp.

I would like to talk a little about workers compensation in more detail. The first question is is workers compensation insurance a business in the first place, thereby being caught by NCP principles? We would argue very strongly that it is a business and it is a significant business in the Australian economy. It is the business

of financing the risk of workplace death, injury and disease. The business has elements of social policy, including occupational health and safety outcomes, injury management outcomes, return to work outcomes and so on, but it is essentially a very significant business activity that can be operated in a way which will gain the benefits of competition and provide those benefits into the economy.

When all governments agreed to NCP in 1994 - this doesn't really need to be said, but I'll just mention a couple of key points - competitive neutrality was a very key component. Clause 3 of the competitive principles agreement, the objective of competitive neutrality policy, is the elimination of resource allocation distortions arising out of public ownership of entities engaged in significant business activities. Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. The net result is that, effectively, 10 years later those principles are not being implemented in public sector statutory class insurance areas.

A particularly essential element of the obligations is that government business activities, like their private sector counterparts, must set prices that enable them to earn sufficient revenue (a) to cover their costs and (b) to include a cost of capital. This is not happening in Australia at the moment. There is a significant lack of adoption of competitive neutrality principles. In 2003 the competition council assessment report on progress of competition policy outlined the benefits of competitive neutrality. I will quote briefly from page 2.2, and this will be referenced in our formal submissions:

> Government businesses cannot rely on the advantage of public ownership, which often encouraged complacency, reducing incentives to improve performance. The application of competitive neutrality principles thus contributes to greater efficiency, better services and cost-effective prices for users. In this way competitive neutrality underpins and complements the performance monitoring regimes that many governments have introduced for their businesses in recent years.
>
> With a competitive neutrality policy in place, governments can better assess the future of their businesses. Full attribution of costs, for example, often leads governments to reassess whether they wish to provide a good or service directly through a government business, allow competitive bidding for the provision of the good or service or withdraw from the market.

As I said, because a number of governments are not adopting competitive neutralities - or have not adopted competitive neutrality principles - this assessment of the true cost of their businesses is not being made and, therefore, a potential

comparison between the provision of goods and services in the public sector versus a more competitive situation cannot be readily undertaken. We believe the onus is on the state governments particularly to implement competitive neutrality principles unless there are very strong reasons for not doing so, and the Competition Principles Agreement acknowledges that. We believe that any strong reasons for not implementing competitive neutrality have not been demonstrated.

I have already made available to the commission - and we will attach to our formal response - a paper I delivered to the Institute of Actuaries accident compensation seminar approximately a week ago, which outlines in some detail the financial consequences of pricing and investment management in a number of workers compensation schemes in Australia. We believe there are very substantial financial issues in these schemes which are not being adequately managed. What does this mean for insurance, in particular?

Competitive neutrality means applying all the usual operational issues that a private sector insurance company would have to abide by, including accurate and transparent reporting based on accepted accounting principles; effective asset management; cost based price setting that does not involve intergenerational or interdepartmental cost shifting; it has to adopt all relevant charges and taxes and duties; it has to include adherence to the APRA general insurance prudential standards, including capital adequacy, assets in Australia, liability valuation, risk management and reinsurance arrangements; and it must also include the maintenance and provision of a commercial return on notional capital.

Previous reviews of a number of workers compensation schemes have identified the need for significant reform. I reference, for example, the Grelman report of workers compensation in New South Wales. Little progress has been made in implementing these sorts of recommendations. This lack of progress was acknowledged in chapter 8 of the interim report for the present inquiry, which stated:

> Continuing restrictions on competition in insurance services should be re-examined sooner rather than later. Unless addressed in other review fora, these areas should be afforded priority under a modified legislation review program.

We strongly support the comments there but, in fact, we believe that the commission should go further. ICA is of the view that the lack of progress under previous legislation reviews of statutory classes - such an approach would probably perpetuate the current situation. Given the national importance of workers compensation across Australia, and also compulsory third party insurance, ICA proposes that a specific program be established under the guise of NCP aimed at promoting, at the very minimum, competitive neutrality in statutory classes of

insurance. ICA fears that, without a very strong carrot and stick approach that NCP can bring, the existing situation will continue and we'll be having a similar discussion on these sorts of areas in 10 years' time.

ICA was and remains supportive of the Productivity Commission's inquiry on workers compensation. We acknowledge the government's response to that report, but we would like to see those recommendations implemented. We particularly believe that there is strong ground for greater national consistency in workers compensation, particularly in a more competitively neutral environment. We again emphasise one of the key recommendations coming out of the HIH Royal Commission, recommendation 51:

> That the states and territories implement a process designed to reduce inconsistencies in their statutory schemes. This is a task which would appropriately be overseen by a proposed ministerial council.

We believe there are very sound reasons for that recommendation to be implemented across Australia. Finally, some very brief comments on a couple of other aspects of the interim report. ICA was pleased to see the focus of the report's discussion on trade practices and consumer protection regulation, where it acknowledged the importance of promoting competitive processes and that poorly designed regulation can actually impose more costs than benefits. ICA hopes that this logic can be applied, in particular, to statutory classes of insurance but, in general, across the entire insurance spectrum.

Secondly, in the area of health, we also support the recommendation that COAG initiate an independent review of Australia's health care system. General insurers, through their participation in compulsory third party, workers compensation, public liability and similar areas of insurance, in insuring personal injury, death and disease, are a significant contributor to health care costs in Australia. Significant funding of health care in Australia comes from the general insurance sector in their administration of compensation schemes and through other product areas such as public liability insurance.

At the moment there is no real understanding of the relationship between the insurance contribution to health care costs versus other contributions to health care costs; for example, from private health insurance, government agencies and so on. That is particularly the reason why we think some sort of broader analysis of health care in Australia is warranted. We believe greater efficiencies would deliver cost savings in the delivery of health care services. In a competitive insurance market, those benefits would then flow through the pricing mechanism into consumers. This is another example of the benefits of applying competitive insurance models to government business enterprises and reinforces the need for competitive neutrality in

those jurisdictions and insurance classes where it's not a reality.

In summary, ICA is disappointed at the Commonwealth government's decision not to implement recommendations of the inquiry into workers comp frameworks, particularly those that would have been a precursor to a truly national solution for major corporate employers. However, this does not diminish the importance of pursuing greater consistency in this area. As noted, ICA proposes that the HIH Royal Commission recommendation 51 be adopted by the inquiry, and that is that the states and territories implement a process designed to reduce inconsistencies in statutory schemes. This is a start, to be overseen by a ministerial council.

Finally, ICA proposes to the current inquiry that a specific focus on statutory classes of insurance be recommended as a priority area of reform very much still outstanding from the current NCP agenda. Thank you.

MR BANKS: Thanks very much.

MR PEARCE: I have some following remarks. First off I should say I am a member of the Motor Accidents Council, which is the advisory body for the administration of the Motor Accidents Act in New South Wales. I appear before you in my role as an executive of IAG and not in any role in the administration of the Motor Accidents Act.

Insurance Australia Group is the largest general insurer in Australia and New Zealand and has emerged as the leading player in Australian workers compensation and compulsory third party motor vehicle accident insurance, which I'll refer to as CTP throughout my discussion. In the field of workers compensation, Insurance Australia Group provides coverage for about 1.7 million workers, policies for 169,000 employers and injury and claims management services for about 63,000 claimants. In the field of compulsory third party, Insurance Australia Group has approximately 2 million policyholders in the three jurisdictions allowing private underwriting.

We at Insurance Australia Group fully endorse the comments of the Insurance Australia Council and the recommendations made by it to the Productivity Commission. IAG believes that the Productivity Commission inquiry is an excellent opportunity for the continued examination of and pursuit of greater competition in the various Australian markets for long tail; that's statutory classes of insurance. This review comes on the heels of both the Productivity Commission's recent inquiry into the national occupational health and safety and workers compensation scheme, and reviews or inquiries in every Australian state into the efficient functioning of these arrangements, such as the Stanley report in South Australia and the McKinsey review in New South Wales.

All of these inquiries found that the pursuit of effective competition between insurance or agents within these schemes should be viewed as the primary means to ensure the cost of insurance is minimised through the functioning of competitive market forces. However, it must also be noted that no clear or consistent idea as to how this competition should be fostered within the schemes has yet emerged from any of these studies. Similarly, these reviews were largely in agreement that competitive environments ensure the development of innovative insurance products supported by research and development initiatives, greater efficiencies in underwriting practices and improvement in vocational and road safety standards.

The failure of the Australian state and federal governments to recognise the significance of reform in the area of workers compensation and the significant impact reform will bring to national productivity goals is therefore all the more disappointing. Nonetheless, IAG is hopeful that this process will provide for additional objective and scientific material to be gathered which will ultimately support a renewed program of activity on insurance matters to be added to Australia's agenda for national competition reform and productivity enhancement. Insurance Australia Group strongly supports the guiding principle of the national competition policy that competitive markets will generally best serve the interests of consumers and the wider community, and that anticompetitive markets favour narrow sectional interests at the expense of the community as a whole.

Because insurance is a scale product, the pursuit of greater competition and the establishment of a national market should be regarded as a central tenet to the meeting of community expectations for reduced premiums achieved through capital accumulation and greater economies of scale in claims and policy administration. The Productivity Commission has recently reported one in every five dollars spent on workers compensation is spent administering Australia's 11 separate schemes, and reducing this is crucial to the reduction of insurance costs on industry.

State government insurance schemes typically operate as statutory monopolies within the borders of a state, and with the state regulatory authority rigidly controlling any commercial participation in these schemes. Such control severely restricts the capacity of insurers who may be active within such schemes as claims managers or scheme agents to compete for market share through superior performance, and therefore minimises the benefits of competition in the long tail insurance market to the Australian economy, and in particular the benefits to commercial and domestic consumers of insurance.

The size of the insurance market open to competition and private investment is even further reduced by the presence of specialist entities such as local government, mutuals and medical defence unions. These organisations operate by mechanisms

such as discretionary trusts and, dangerously, outside APRA's prudential regulatory framework in which private insurance companies must operate.

By international comparisons, the high number and variety of state and territory government-owned and/or managed insurance schemes makes the Australian insurance market unique. The ad hoc and independent development of CTP and workers compensation schemes in the Australian states has made each scheme significantly different from each other. The ease with which Australia might move towards greater scheme harmonisation and the development of a uniform insurance model is hindered by serious practical and political difficulties that result from the very different features of each of the state schemes as they now stand. It is worth stressing to the commission that the markets in which private insurers now underwrite the two major long tail classes are generally enjoying strong levels of competition and, in historical terms, more affordable premiums in spite of the markedly more stringent capital reserving requirements imposed by APRA after the HIH collapse.

Through the NRMA Insurance brand, Insurance Australia Group is the leading insurer in the largest competitive transport accident liability market, New South Wales. Through the CGU brand, Insurance Australia Group is the largest private sector workers compensation provider in Australia, particularly in Australia's largest privately underwritten insurance market, Western Australia.

The public sector's domination of the long tail insurance business and the fragmented regulatory framework for the private sector has impeded the development of a viable sustainable large-scale market for long tail insurance in Australia. This of itself impeded the development of a capital accumulation within the Australian insurance market. Conversely, state monopoly insurance has imposed massive capital strain on the Australian public sector and indirectly reduced its ability to meet rising community expectations from approved funding for core government activities such as providing roads, schools and hospitals.

In contrast, the need of insurers to service private capital creates a natural commercial discipline, optimising the efficient delivery of entitlements. This is in addition to the APRA prudential and other regulatory requirements which private underwriters must observe but which do not apply to state insurance schemes. This is in due part to the Commonwealth Insurance Act, which specifically excludes state monopoly schemes from having to comply with a variety of federal regulations, including those imposed through APRA. As a result, most publicly underwritten schemes do not comply with APRA's prudential requirements, and carry large unfunded liabilities. This leaves open the opportunity for political considerations to govern and influence the cost of insurance and therefore the nature and scope of benefits available to injured workers.

By contrast, private underwriters must comply with the Insurance Act and therefore be adequately funded to pay claims. Their primary focus is on minimising the transaction cost and improving injury management and resolution as the best means of reducing or controlling their costs, other than accident prevention. This creates a natural incentive to work with individual employers to prevent injuries and, therefore, claims in the first place, as well as to assist the claimant to minimise their disabilities and effect an early return to work.

As an insurer, there are two observations worth highlighting. Internal competition in schemes: it is clear the benefits of competitive tension are already recognised in some jurisdictions. In New South Wales, WorkCover reforms are currently attempting to create an environment of greater competition within the scheme. This is a recognition that competitive tensions result in superior scheme performance. Put simply, states are opposing the introduction of competition to insurance markets nationally, at the time when they are introducing it into their own schemes locally.

Process issues as impediments to competition: it is worth noting that many impediments to enhanced competition are the unintended consequences of prescriptive requirements placed upon various standard procedures that insurers must regularly undertake when administering the schemes. The submission addresses the disadvantages of multiple state schemes, such as data, the depletion of insurance skills, multiple systems, multiple barriers to entry to the insurance market.

It would not be possible to promote competition in the Australian market in these classes of insurance by breaking the territorial nexus between state monopoly schemes and the relevant state's legal jurisdiction. The only realistic means of promoting competition in the Australian insurance market is to create a single national market for these insurance products, governed by either a single piece of Commonwealth legislation or through identical pieces of state legislation in every jurisdiction.

In order to prevent future divergence of these schemes, it would also be preferable for the states to refer to the power to make future laws in respect of OH and S and workers compensation to the Commonwealth. The creation of such a national market which exclusively covered all classes of employers would require the winding up of the old schemes in each state. The issue of how the unfunded liabilities of those publicly funded schemes might be retired, for example, by a levy on employers in the relevant state, would seem to be the most serious obstacle to the realisation of a national scheme for each class of insurance.

A less drastic alternative might be to simply allow employers engaged in trade

and commerce in more than one jurisdiction or whose employees must constantly cross state boundaries to become insured under a privately underwritten national scheme operated by the Commonwealth for national employers. This would not realise the efficiencies possible for the administration of the scheme itself, but it would allow industry - in particular, large exporters - to at least address its compliance costs issues. It should be acknowledged by the commission that the existing publicly underwritten schemes are not consistent with existing national competition policy arrangements.

The persistent underfunding of the liabilities of these schemes by state government regulators and the fact that APRA standards do not apply to state insurance under the Commonwealth Insurance Act means that competitive neutrality is not observed between publicly underwritten and privately underwritten schemes. State schemes not subject to APRA regulation regularly underfund their liabilities by charging insufficient premiums, given the false appearance that publicly underwritten schemes are less expensive and more efficient than private schemes. A privately underwritten scheme for multistate or national employers would clearly be supported by the constitutional grant of power to the Commonwealth over insurance other than state insurance, also "state insurance extending beyond the limits of the state concerned", and could be legislated for unilaterally by the Commonwealth.

The Commonwealth may unilaterally legislate to allow employers to have access to the Commonwealth system without the states' assistance in passing legislation to allow single-state employers to leave the state schemes. However, expanding access like this might raise political issues for the Commonwealth in respect of the feared impact on premiums for those employers obliged to remain in the state scheme. With New South Wales WorkCover's permission, IAG had an actuarial analysis of the impact on the New South Wales state scheme if all of the large employers within the scheme sought to leave the Commonwealth Workers Compensation Scheme or self-insurance. This analysis was undertaken by Deloitte Trowbridge.

Trowbridge was able to report that the elements of cross-subsidy that previously existed within the state scheme had been more or less systematically reduced if not eliminated by WorkCover in an effort to punish employers responsible for a lot of accidents and reward those who successfully reduce and manage risks. The result is that the impact on premiums of a wholesale departure of this strata of employers would have a negligible impact on the premiums for small and medium enterprises remaining within the schemes. Although it would have a negligible impact on premiums for SMEs, the creation of a national scheme of privately underwritten workers compensation insurance open to multistate employers only and possibly to those employers with employees who must regularly cross state boundaries would be consistent with the national competition policy arrangements to

date and could be a vital interim step down the road towards a truly national workers compensation system.

Although the expansion of the class of persons capable of accessing the Commonwealth scheme under the Commonwealth Safety Rehabilitation and Compensation Act 1988, currently only available to self-insurers, would have a significant indirect impact upon the state schemes. This impact would be so incidental and remote as to not constitute legislation with respect to state insurance and therefore would be within the Commonwealth's power and not caught by the state insurance exclusion under section 51(14) of the Constitution. Such a scheme would address the most important issues currently detracting from Australia's international competitiveness by allowing such multistate employers to have to conform to only one set of occupational health and safety requirements and only one set of compensation benefits.

The Commonwealth could therefore legislate to allow states to opt in to the national scheme after it had been set up by the Commonwealth by passing the necessary complementary legislation. The content of this legislation could be specified in the Commonwealth's own act and would require three basic elements: that no new business be written by the old state scheme and that this be wound up through the run-off of existing claims; that the cover offered by the national scheme be adopted by the state as a legislatively-required means of meeting the obligation to obtain workers compensation insurance instead of the now-defunct state scheme and that the states' power to legislate in future in respect of state schemes of workers compensation insurance in OH and S in the future be irrevocably referred to the Commonwealth parliament.

Similar legislation could be used in respect of the various state compulsory third party insurance schemes where even less participation is currently available for private underwriters. It would also mean that as soon as the premiums available under the national schemes were lower than those under the state schemes, there would be political pressure generated by single-state employers and motorists to have their state join the national system to give them access to the lower premiums. IAG supports the call from the insurance industry for a specific focus on long tail classes of insurance as an area of priority or of reform. This is best pursued under a specific competitive neutrality program. Thank you.

MR BANKS: Thank you very much. For the benefit of my readers as well as myself in terms of the transcript, "long tail" insurance derives from what?

MR PEARCE: It's principally bodily injury, workers comp and CTP insurance. It's called long tail because typically, the claims take some years to finalise.

MR BANKS: As in the case of asbestos.

MR PEARCE: As in the case of - yes, asbestos, that's probably the longest tail because it can take 10 or 15 years before the underlying problem shows itself but even with just a workers compensation claim, it can take some years before the worker is in a position to go back to work; simple as that. It takes time for the injuries to heal.

MR BOOTH: Long tail as opposed to short tail. Short tail are normally routine home and motor type insurance claims where the incident occurs, the claim is made, assessed and paid within a relatively short time frame, normally no more than months whereas, as Doug says, in personal injury, an incident occurs, a claim is made but the average time for most personal injury is in the order of three to five years for the bulk of claim payments to be made for any given period of time.

MR BANKS: You had as appendix 1 in your first submission a nice summarised account of the differences across jurisdictions. To what do you attribute the differences that we observe there in times of the extended private underwriting and in competition that we see? I mean, clearly, there are some jurisdictions which probably have regimes that you would be reasonably happy with, others clearly not. Why are we seeing a difference?

MR BOOTH: It's not clear to me. I mean, it's quite interesting that New South Wales and Queensland have private sector CTP public sector workers compensation. In Tasmania and Western Australia, they have public sector CTP private sector workers compensation. Each state probably thinks they have got the right balance. I suspect that firstly, there's a lack of understanding of the way in which a private market can actually operate in some of these areas. Secondly, there is a fear which is, again, from lack of understanding that private sector competition by definition is a more expensive mechanism to provide the insurance service.

We would argue very strongly, based on experience - for example, both New South Wales CTP and Western Australia workers comp, if the benefit framework is in place and is operating in a reasonably stable manner, the competitive nature of the insurance market will deliver real benefits over time back to the community and Mark Lever who is with us has more detailed information on that sort of a thing if you're happy to take it.

MR PEARCE: Before you do, I might just add that I think the reasons why some schemes are private and some schemes are publicly run is more historical than ever, having been properly thought through. I think all of the schemes originally when set up were privately underwritten, but it's the process of political intervention in pricing that has typically destabilised that and, when that has occurred, insurers one by one

have typically left the scheme, so that the scheme has ended up either as a monopoly, in what was the state government insurer at the time, and then ended up as a scheme.

MR BANKS: Is that situation now in itself an obstacle to reform; the fact that there are unfunded liabilities or, potentially, cross-subsidisation going on and so on? Are they reasons why some jurisdictions are not - - -

MR BOOTH: We would say that in many cases the current financial positions of the scheme would be real obstacles in the short term to alternative arrangements. For example, our goal at the moment is to work with the New South Wales government in terms of workers compensation. As at 30 June 2004, New South Wales workers compensation had an unfunded deficit of approximately $2.3 billion. You can't fix that sort of a program in a short-term framework. It will take probably three to five years worth of financial rehabilitation to restore that.

It's the reason why, in our submission and in the remarks today, we are emphasising a need to move towards competitive neutrality, so that - as was commented or noted by the NCC - if you reach a point of genuine competitive neutrality, you can then start having an intelligent discussion about the merits of operating this business in the public sector versus the private sector, but whilst ever the public sector schemes are not being priced correctly - which is the case at the moment - you actually can't have that discussion.

MR BANKS: Thank you.

MR LEVER: I just thought it might be useful to illustrate the dynamics that are occurring in the compulsory third party markets that are competitive at the moment and perhaps contrast that with what is occurring in the public sector monopolies. The common feature of probably most motor accident, transport accident environments in the western world, certainly over the last five years or so, has been quite a marked decline in the frequency of claims; that is, the frequency of bodily injury.

I think we're still trying to understand that, but I guess the difference between the competitive markets and non-competitive markets has been the speed and the magnitude with which that has passed through to the consumer, the cost savings. To some extent, those savings are offset by a continuing increase in the cost of those claims, because they're driven largely by things like compensation for lost earnings and medical costs, which typically rise faster than inflation, but the decline in claim frequency has underpinned quite a dramatic reduction in prices in New South Wales.

All schemes have experienced similar reductions, but I was just looking at the media coverage in the last week or so for some most recent examples. We don't

often talk about competitors, but AAMI managed to get the premier to announce a reduction in their price in New South Wales last week. The benchmark price, if you like, is now below $330, which was the ceiling that was set when the scheme was last changed in 99. That ceiling did not include the GST, which was added the year after, so the price has come down in real terms quite substantially. I've got a couple of graphs here, which I'm happy to circulate.

Queensland's market has been a little bit different, because there was a real explosion in claims costs two or three years ago when there was a definite increase in entrepreneurial plaintiff-lawyer activity, I suppose you'd call it. That seems to have stopped now as a result of some tort reform that Queensland put through in the last nine months. Queensland has quite a different market dynamic in the way it's regulated, but there is a blind quarterly filing process and that's seen prices come down by about 10 per cent on average in the last nine months, which is quite significant, and that's flowing straight through to the consumers, as those savings became evident in claims costs, and on top of the effect of the reduction in frequency that we've been seeing for the last few years.

In contrast, I just noticed in my clippings yesterday, the Territory Insurance Office, which is the last government-owned monopoly insurance company, saying, "Well, we've had a good year but we're still putting the price up because we need to rebuild our balance sheet." I'm happy to just leave these as exhibits. There's another graph here which does compare the premiums in the states over the last five years. It's fractionally out of date, because it hasn't picked up the last couple of changes in the last few weeks, but I think the point is that these markets are dynamic. There are other benefits which are less visible, but because we want to build a relationship with these customers, "If you have more than one product with us" - and I think most insurers have similar arrangements - "we'll give you discounts on other products."

We're the only insurer that provides it in New South Wales, but we have an at-fault driver cover, which provides sort of lump sum benefits for very serious injuries if you're our customer and you have an at-fault accident and not covered by the Motor Accident Scheme. The market is very dynamic, and becoming increasingly so, and I think it really does contrast with the pricing policies of the monopoly schemes.

MR BANKS: Good. Okay. With those exhibits, we'll have a look at them, but could they be incorporated as attachments perhaps to the submission that's coming, just so they will be publicly available?

MR LEVER: Yes. Probably need a little bit of explanation, but yes.

MR BANKS: Good.

MR WEICKHARDT: I really only have one other question, because we had a very good discussion in Sydney and I don't think the fundamental position has changed a lot since then. I note with interest the Victorian government saying the sky is going to fall in if Optus leaves the workers compensation scheme in Victoria. I assume, based on what you've said about the New South Wales scheme and generally what appears to be the case, that you think those claims are overblown?

MR PEARCE: I think so, because the same claims have been made by the WorkCover Authority in New South Wales, so I'm not too sure, and I'm not sure where they're coming from, because I know the Victorians have spent a lot of time trying to - similar to New South Wales - just to get rid of a lot of the cross-subsidisation. In fact, in the past - it's quite interesting - in many of the sectors where there was cross-subsidisation between small and large business, and retail was probably the best example, the cross-subsidisation in fact worked the other way. It was the small corner shops that were subsidising quite significantly Woolworths and Coles. In fact, the really bad accident histories were the large retailers, not the little shops. So it's not nearly as simple an argument as is put forward.

We also actually have serious doubts as to the validity of their challenge, having looked into the constitutional aspects of the state insurance and the state monopoly schemes. We had sought advice from Steven Gagler QC, who is an expert in constitutional law, and although it's a very esoteric part of the law it's pretty clear from what we've seen that - well, the reason the state governments can set up the state monopoly is not because of the constitutional carve-out in the Constitution itself - that enables the state governments to set up insurance companies like the GIO or the TIO that can then operate in the competitive insurance market.

To take it the one step further, to then impose monopoly criteria on a marketplace, that right - I suppose it's a negative right - comes from the regulations around the Insurance Act that then just exclude these schemes. Once they're excluded, they're then able to act in any way they like. So it's not just the fact that the state governments have that legislation; it's in fact that the federal government, through the regulations surrounding the Insurance Act, have overridden the underlying powers of the constitutional carve-out.

MR LEVER: Or extended it.

MR PEARCE: Or extended it, yes.

MR LEVER: There's a 1972 regulation that says, "Nothing in this act will override anything that a state wants to do in relation to its own insurance markets." That's all it says.

MR PEARCE: And it's interesting that it's in a regulation rather than a fundamental part of the act itself.

MR BOOTH: Just in relation to Victoria, as at 30 June 2004 - according to their annual report - there were 38 major employers operating as self-insurers for Victorian workers compensation, so the fact that there is already a significant body of employers self-insuring, if one further employer took the step to self-insure, I can't imagine that there would be major disruption to the scheme. They also reported what happened to be the largest insurance profit of any entity in Australia for 2004, with a profit of $1.2 billion. It was made actually in a public sector entity rather than the private sector. I don't know what that says, but it's interesting.

MR BANKS: Okay, good. There was the issue that you raised about separate approaches under NCP for statutory classes of insurance, and I guess you'll flesh that out a bit in your submission, because a question does arise: where to next? We've indicated that we think there's a strong case for further review, and sooner rather than later. As you say, some of the fruits of the past reviews have perhaps not been as abundant as you might have expected, so that question of, I suppose, procedurally how you would carry it forward is, I think, of some interest.

MR BOOTH: I think the NCC has clearly struggled in the area, with a whole range of reviews having been done - and I think clearly real doubts - but having probably some difficulty in assessing the merits of the reviews and so on. We strongly believe that, given the lack of change in the last five to eight years, the area does need quite strong emphasis for the near future, otherwise the status quo will probably continue. That's why we very much welcome the suggestion and prefer for that recommendation to go forward to government as a very strong recommendation of outstanding work still to be done.

MR BANKS: All right. Thank you very much. We'll now break for lunch, proposing to resume at 2.15. Thank you.

(Luncheon adjournment)

MR BANKS: We're going to recommence this afternoon. Our first participant is with the Eros Association. Could you please give your name and your position with that organisation.

MR SWAN: My name is Robbie Swan and I'm the director of the Eros Association, which is Australia's national adult goods and services industry association. In a way, we are like the National Farmers Federation for the sex industry.

MR BANKS: Okay. That's a nice analogy.

MR SWAN: Yes.

MR BANKS: Thank you very much for attending today and also for the submission which you sent us back in June. We haven't seen, I think, a written submission so far in response to the draft, but we'll give you the opportunity to raise whatever points you would like to make.

MR SWAN: Thanks, Gary. I have a few but, please, you ask questions of me as we go along. I would prefer to do it that way, if that's okay.

MR BANKS: Okay.

MR SWAN: In the first instance, one of the biggest problems that we have faced as an industry is the sort of discrimination against the industry, using unfair competitive practices as a kind of weapon, I suppose you would say. It's a bit difficult sometimes when you are dealing with the adult goods industry especially because, whilst the products are legal, there is a certain morality around them which we will recognise and, because they tend to be blush-making in some areas, you don't get a very fair hearing.

I would have to say that in my initial application to the ACCC with the submission, what, three years ago now about the problems that the industry was having, I've struck this problem of not wanting to take us seriously from various people in various organisations along the way, almost like being dismissed or your issues are being dismissed because you are from the sex industry or these products have a moral edge to them, and I just wanted to say that I think that is actually very unfair and it's not a good way to go because often in these situations, I think, it's those areas that throw up issues that later on down the track turn out to be major ones; that they come to the fore with organisations that might appear to be on the margins, but down the track they end up being mainstream issues, and I think it's important to tackle them as they arise.

The first thing I want to say is that the sex industry itself, or the adult goods industry, in Australia - it's not a cottage industry - turns over $1.8 billion a year, which puts it pretty much in the same area as the plastics industry or the sugar industry, and that is never acknowledged by the authorities. It's sort of pushed away, but it's not a small industry and there are a lot of issues around an industry that big which can make bad public policy if they are not dealt with. There are two public companies in the adult goods area which suffer badly because they are not able to properly fulfil their shareholders' profit expectations, because state governments will only let them trade in "favoured products", I think the NCC is calling it.

That's the issue I would like to raise first of all here today, the issue of this ability of state governments under the title of "harm minimisation legislation" to make these kinds of false and erroneous judgments about ordering their goods and services. In Queensland, which is where the main issue arises here - I brought in a couple of examples here. These videos are on sale in video libraries throughout Queensland, and probably through other areas as well, through adult shops and whatever, quite legally. They are R-rated. This market is worth probably $4 million, $5 million a year; that's in the sort of sex education market.

I'm holding up here the Better Sex video series. I know that one of our clients, Gallery Global Networks, which is a listed company in Australia, sell a lot of these tapes into Queensland. If you put that tape into a book or a magazine so that it gets an R rating in a book or a magazine, which is what these two are - classified category 1 - that will bring you two years in gaol in Queensland if you try and sell them. They're exactly the same. There's absolutely no difference between the images in these books and in this video.

In reply to conversations that we've had, and to our accusations that this is an unfair environment and that the Queensland government actually hands these people 4 or 5 million dollars a year and then puts these people, the publishers, in gaol, I had a letter back the other day from Mr Gerard Bradley, who is the under-treasurer in Queensland, and he says:

> The Queensland government does not believe that there is an inconsistency in regard to this matter.

That's within the Classification Act.

> The publication in question is being treated on its own merits, in line with all other publications of its classification; that is a category 1 publication. It's being judged in its own context, not that of films from which it derives.

That's a nonsense argument:

> Material which may not offend in the context of the film may breach the relevant criteria when included in a publication and it is based on an assessment in relation to the open and transparent criteria set for publications on which its sale has been prohibited.

I think everyone here would have to say that is an absolute nonsense. It's totally illogical to anyone who has ever seen a sex education R-rated video and then looked at a sex education book of the same standard. It just doesn't make sense. Mr Bradley, I would say, has lied straight out.

MR BANKS: Does the book have some words in it as well?

MR SWAN: Yes, there are a lot of words.

MR BANKS: I was going to say the book is less accessible, in a sense, than the video because you have got to be able to read, presumably, to deal with part of the book at least.

MR SWAN: Correct.

MR WEICKHARDT: Is there a one-to-one correlation with every word spoken in the video and every word written in the book?

MR SWAN: Not this one, no, but if you were to put that R-rated video in a book, frame for frame, without any change or alteration - just simply still-frame everything - and publish it in a book, it would get the category 1 classification and vice-versa. If you put that book on a video - even as still pages - and read it as a book on video, it would get an R rating. They are totally interchangeable. They are the same thing. On the Office of Film and Literature Classification web site this morning - this is a Commonwealth classification authority - they say that, "Impact may be lessened where reference to a classifiable element is verbal rather than visual."

What that means is that the verbal is like reading, you know, blah, blah, blah, books, which is really words in a book, whereas the visual one of the same thing, they're saying, may be slightly higher, but not much, which is totally the opposite to what Mr Gerard Bradley said. He is trying to argue the other way. I just think this is really disingenuous that he has written this, and I would have to say that it's a political statement. That's what it is. He's lying on behalf of Peter Beattie, the premier.

MR WEICKHARDT: Presumably, they're two different bodies that look at these,

are they? There's a different group of people that look at the book versus the video in Queensland?

MR SWAN: You mean a different audience - - -

MR WEICKHARDT: No.

MR SWAN: - - - or different censorship?

MR WEICKHARDT: In terms of giving it a rating.

MR SWAN: No. All state governments use the Officer of Film and Literature classification to determine their classifications. There is only one - - -

MR WEICKHARDT: For films?

MR SWAN: Films and books.

MR WEICKHARDT: And books.

MR SWAN: Yes.

MR WEICKHARDT: So it's exactly the same organisation that gives it a rating?

MR SWAN: Correct.

MR WEICKHARDT: I see.

MR BANKS: Otherwise, you could imagine that literature has a longer tradition and history and maybe more constraints that have come from the past than, say, videos, which is a relatively modern medium, and explain it that way. But if the same body is looking at the two different forms of medium, then that's hard to explain. I think you've said in your submission, indeed, in other jurisdictions it goes the other way.

MR SWAN: That's right, and that's what makes this so silly. I don't know of any other sort of harm minimisation system in Australia. I understand why it's called harm minimisation, in a sense, but it's not like the regulation of alcohol, where there is a potential for harm. Clearly, this just doesn't have the potential for harm. It's got the potential to offend some people - I understand that - so I suppose in that sense it could be, but we don't accept that the Classification Acts in the states are harm minimisation legislation. We think they're just an ordering of goods and services, or goods.

You are right, it goes the other way in the other states, and I have just brought along a couple of examples here to show you. I have brought in the latest edition of the Blockbuster X-rated DVD, the Blockbuster video and the book. The book I don't have, because it hasn't arrived from overseas, but generally they come together. This is a private book which shows on the back the private videos that they do, and when I have got that it will be here like that. It will be the book, the video and the DVD, and they are all imported into the country together.

Let's forget Queensland for the minute, because it has the different regime operating with lesser classifications, but in all the other states - not the territories but the states - the sale of the book is quite legal. It's just a category 2 publication, but it shows exactly the same thing as this does. It's exactly the same. It's identical. I mean, these really are identical, these ones, because they just make the books from the videos. They just freeze-frame them. The book has been legal to sell in Australia since 1971 when Don Chipp changed the customs regulations in Australia, as the minister for customs and excise then. That book has been legal to sell in all the states as a category 2 classified publication. But with the video and the DVD, which are identical, you'll go to gaol for two years for selling them, which is just a nonsense, in the sense that there's nothing in the book that you can't see in the video. They're identical.

The problem - just using this one, for example - is that these videos and the books are owned by Adultshop.com, which is a listed company in Australia. It was the first company to float on the back of the sex industry. They can only sell these in the ACT and the Northern Territory, whereas they can sell that book in all states and Perth. But their shareholders are clamouring about this, because Adultshop can't open retail outlets in the states because it's not profitable to open a retail outlet without selling these products. These products are for sale in the states on a black market, and the police refuse to police it because they don't want to waste their time and resources on a stupid moral crime. But the thing is that if Adultshop goes and breaks the law directly, and opens up shops and sells these, then the chief executive officer risks losing his job and the company risks being struck off the ASX, I suppose. This is a major problem for shareholders in public companies, I think, that want to invest in this stuff.

I should mention here that in May this year the federal government enacted a change to the Federal Classification Act, the aim of which, in the minister's explanatory memorandum, was to bring video games into line with videos and publications and the whole lot, to try and centralise video games under the same rating system as the rest of the thing. This was done as a recognition that technology is merging and very soon all of this, including books and publications, will be available on one screen. It's already there. You can already bring in X-rated material

from a satellite if you pay 5000 for a dish and bring Red Hot Dutch in from overseas. There's nothing that the Australian Broadcasting Authority can do to stop it, because it's not illegal. But it's a silly nonsense to think that, just through this unlevel playing field, governments can try and somehow order the sale of these goods in Australia, because it just doesn't work. All it does is create black markets and stop legitimate players who want to trade in the right way, who own copyright and do all that, from doing the right thing.

I think that very soon the federal government will scrap the category 1 and the category 2 classifications on their books and magazines. In fact, what they will become is R and X-rated. I don't know what the Queensland government - or all the state governments - are going to do then, because then they're going to have to make a decision about whether they're going to ban that to make the level playing field, or legalise that, because they can't have it both ways.

I would just like to say one more thing about this; that in the states there is a huge black market now in this material. You can buy this material now in suburban markets, where kids have access. Every second video library now in Melbourne and Sydney stocks this under the counter. It's totally illegal. The video shop owners - you know, two years' gaol for each one - but because the police don't want to police this crime any more - and, by the way, it's not illegal to buy this and it's not illegal to have it or to possess it in the states. It's only illegal to sell it. I can't think of any other product in Australia, except maybe some uranium products, where it's legal to possess it and legal to buy it but not legal to sell.

I just think, again, that the states have got to get their act together in this and come into line with the national classification scheme here, rather than pulling away from it all the time and causing these huge black markets to develop where, to be honest, they're perfect breeding grounds for child pornography and refused classification material to spring up, because the police don't want to know about it. They're in public areas where no-one really wants to know about it and they're under the counter. At least in adult shops - the restricted premises that are permitted properly by the local council - people who run adult shops are pretty good about restricting age and they're pretty good about selling really bad material. They won't do it.

I would have to say too, briefly, that the Western Australia government only recently came on board. It was the last state to come on board the national classification scheme with publications, where they disbanded their state censorship board. This was about a year ago. But they still charge an annual registration fee for people who want to sell category 2 publications. In a sense, the state government in Western Australia even takes money from this kind of situation. It's not like they're just saying, "Well, go and do it." They actually make money from ordering the

goods and services, so that there's a favoured product.

In Queensland, to be honest, I would have to say that it's such a strange situation up there, and the government throws such a huge forward pass to the manufacturers of this kind of material, to the detriment of the people who do that, that you would have to wonder if there's not some - I don't know how many politicians have got shares in Blockbuster Video up there, but it makes you wonder, I think, that there's a potential for the authorities to be involved in some kind of favoured activity. If they know that there are large sales of this, because you can't sell that legally, then I suppose it would be good buying shares in these people.

MR BANKS: Are there any statistics on the relative turnover of, say, videos versus books in this area? What would we expect to happen in Queensland, say, if they change this rule that penalises literature?

MR SWAN: I think you would find that a lot of general bookshops would start to stock category 1 material in plastic bags that they are allowed to. Remember Madonna's book a few years ago - you know that platinum-covered, titanium-covered erotic book she put out? It was sold through bookshops round Australia but it was in a plastic bag, so you couldn't get into it, and it sold out within a few days, but it couldn't be sold in Queensland. I suspect that there are a lot of those big picture books that are rated category 1 that would end up in newsagents and in proper mainstream bookshops. Those people wouldn't go near that now.

I don't think we would see so much a change in sex education books, because that's more popular on video anyway, but people should have the choice. But this kind of book, like Libido from overseas, which gets a category 1 rating because of the explicitness of the love-making in there - I mean, these sorts of books would do very very well in adult shops up there. At the moment, they don't sell them, because they know - well, actually they do a little bit. In fact, a 61-year-old grandmother was fined $600 in the Brisbane Magistrates Court only last month for selling a category 1 book up there.

MR BANKS: She could have bought it but she couldn't sell it.

MR SWAN: That's correct, yes. If a product is that bad, they should ban the possession and the purchase of it, not just criminalise the sale. I just think that, in itself, is not a good perspective.

In a sense, I would like to suggest that there is a political dimension behind the state governments' unwillingness to allow the same product to be sold in different ways like this. That's why I'm wondering whether the commission has some sort of jurisdiction in that way. Clearly, the letter from the Queenslanders has said, "Go

away, we're not interested in this," even though they've lied. It's clearly fraudulent, what they've written down here. I can't see that the National Competition Commission - apart from its ability to fine state governments for doing this, it has no other clout.

I just think that when state governments enact anticompetitive legislation for purely political terms - which is what this is, and that's why I think that, even though this is the adult industry and adult products, it's important because it introduces this element. It's almost like a political corruption. It's about creating an unlevel playing field, so that politicians can score political points off it. Every election time in the states we see state governments trotting out new pornography laws or suggestions they're going to clamp down on this and clamp down on that and this sort of thing.

It's my opinion that state governments maintain these bans or these unlevel playing fields because they want issues at election time. It's not good for consumers. People go to gaol every now and again for this sort of behaviour. It makes a mockery of the proper retailing of legal products and I would like to see the commission maybe suggest to the federal government that somehow there is a bigger stick to be waved at state governments for doing this sort of thing because it's just reprehensible that they are allowed to do it and get away with it.

MR WEICKHARDT: You said in your submission - I have forgotten when it was dated, but some time ago - that you were in contact with the Victorian premier's office over a month ago, but no contact has been made. Is there any update on that?

MR SWAN: No. I have sent letters to all the state premiers since then and I haven't received any replies back. It's like they consider it's probably not worthwhile replying. Again my feeling is that they don't want to address this issue because they use it for political purposes at election time - not a lot of feedback - and in fact I think it took the National Competition Commission three letters to the Queensland government to get this one letter back to me, which again at the end said nothing.

MR BANKS: To what extent were these provisions covered by the original Legislative Review Program? That review program which was covering anticompetitive regulation presumably would have picked up the head legislation under which this - - -

MR SWAN: No. Interestingly enough, Mr Gerard Bradley here says that the Queensland Classification Act didn't fall within the gambit of that review, which I couldn't - - -

MR BANKS: Clearly it has an impact on competition - or the market - and because it has a social purpose doesn't actually exempt it, I wouldn't have thought. It's

something that, because there is a public interest test in there, the restrictions could be measured against. Gambling regulation, for example, was part of the Legislative Review Program.

MR SWAN: That's right. It was, wasn't it?

MR BANKS: Sometimes referred to as "a questionable pleasure" also.

MR SWAN: Yes. I think prostitution was not. I think it was left out.

MR BANKS: I don't know.

MR SWAN: Or exempted.

MR BANKS: Yes.

MR SWAN: Mind you, I think this is probably closer to gambling than that, but I have to say again, I don't see adult entertainment as necessarily being part of harm minimisation, but I suppose that's another argument and something we could talk about. But no, the Queensland government believes that their Classification Act is not required:

> The Competition Principles Agreement does not require the government to undertake an NCP review of the Classification Act or whatever legislation gives rise to the ban and it does not intend to do so.

MR BANKS: And in your understanding there is no other jurisdiction which has actually looked at - that is a state act, isn't it?

MR SWAN: Yes.

MR BANKS: And no other state that you are aware of has actually reviewed that act under the Legislative Review Program?

MR SWAN: No, I am sure they haven't, which is interesting because at one level - especially if we go back to the X-rated video scenario in the states with the category 2 publications, the identical media, in the year 2002 all ministers on the Standing Committee of Censorship Ministers signed off on new guidelines for the X rating. They all put their signatures on a document and, in doing so, they're ratifying the National Classification Code, which says that there is a category for an X rating and it will have this and this and this - these elements - in it, so they sign off on it, which means - as far as I can see - on behalf of the people in the state they are from, on behalf of the citizens of the state.

They're signing their agreement that these guidelines for the X rating are suitable for Australians. That's what they are doing. I actually had that in a letter somewhere from Des Clark, the chief censor, that that's what they do. After they have their SCAG meeting they go back home to their jurisdictions where they have made the same video illegal to sell. I think that again this is just another layer of that unlevel playing field. How the hell can they ratify this classification as suitable for Australians and then turn around and say, "But it's not okay for South Australians or for Australians in South Australia," or, "It's not okay for Australians living in Victoria." You see what I mean?

MR BANKS: Yes.

MR SWAN: I just can't understand how they can posit that within the Commonwealth there is not a common morality, as well, and therefore their state Classification Act should follow the National Classification Code, which says that there is an X rating and it's suitable for Australians. I think that their enactment of bans on this material - but the legality of that material in the states could well be unconstitutional under section 92, but I'm not a constitutional lawyer so I couldn't go into that in any detail.

MR BANKS: I guess in relation to the Productivity Commission we don't have any real jurisdiction. We're an advisory body and governments don't always heed our advice. Even so, the NCC clearly has more of a role in relation to the NCP and in terms of competition payments and so on and I guess it would be up to them to see how they read the omission of that legislation from the Legislative Review Program. The other issue for us is, we have a fairly wide-ranging review which makes it impossible really to get into the detail of that, but if you can persuade the treasurer to send us an inquiry into the sex industry then we will do our best to get to the bottom of it.

MR SWAN: Fair enough.

MR BANKS: I don't think we have any more questions.

MR WEICKHARDT: No.

MR BANKS: We'll leave it there. Thank you very much for coming along with such interesting exhibits.

MR SWAN: Thank you. I appreciate the opportunity.

MR BANKS: Our next participant is from the Balanced State Development Working Group, BSDWG. Welcome to the hearings. Could I ask you, please, to give your name and your position with that body?

MR HALTON: Thank you, Mr Chairman. My name is Charles Halton and ever since that group was established in the mid-1990s I have been co-convenor. I should say at the beginning, not only on my own behalf but on behalf of my colleagues, that we were quite distressed to hear of Robert Fitzgerald's illness. We send him our joint best wishes. Many of us over the years have had dealings with Robert, both in relation to ACOSS, in relation to JOBfutures - which you may recall he was the founding chair of - - -

MR BANKS: Yes.

MR HALTON: - - - as well as NCC, PC and a number of other worthy bodies, both Commonwealth and state, so we were very sorry to hear what had happened and pleased to hear that he is on the road to recovery.

MR BANKS: Thank you. I will convey that and, as I say, I told him that the transcripts will be on his homework agenda when he is feeling up to it in the new year, but I shouldn't give him too rich a diet too soon.

MR HALTON: Right.

MR BANKS: In terms of your organisation perhaps - as I have done with others - if you could explain a little bit more about the membership of the organisation and its functions and so on.

MR HALTON: It's an organisation that is pro bono. It's totally voluntary. Its membership ebbs and flows. It initially came together with a group which was predominantly from New South Wales and the ACT but, to some degree, from Victoria, and there was - I think I best describe it as - occasional representation from the southern half of Queensland. Basically it was a group which, frankly, was concerned that in a lot of the material and bodies that we had to deal with there was perhaps an understandable but unfortunate preoccupation with goings-on in metropolitan areas and the very large urban areas. The number of people who had an awareness or a sympathy with regional, rural and remote parts of Australia, and the people who lived in those areas, was, for example, nothing like as intense - if that's a reliable word - as it was for example when I and my family first moved to Australia at the end of 1973.

MR BANKS: Yes. Do you have members of this working group who are from rural and regional Australia?

MR HALTON: Yes. In fact, that's one of the reasons for the tail end of the covering letter to our most recent submission to you because in fact one or two people have said, "Well, didn't Charles Halton live in Canberra?" What does he know about regional and rural?

The truth of the matter is if you look at where I've lived, in fact this is the only time since I left university and came down from London, that I have lived in a city as close to the centre of things. Given the positions that I've held in the public service I frankly had little alternative but to do it. But, in fact, even then I had property and still have property outside, and that was a pattern in Canada, and that was a pattern in the UK. There is a slightly flippant remark in that covering letter, for example, that although when I was in the Canadian public service I lived 40 kilometres outside Ottawa, at a place called Barrhaven, which had a primary school and also had a snow pile, not once in five years did I ever fail to get into the office in the centre of Ottawa.

I lived nearly 40 kilometres outside the city of Bristol in Gloucestershire in a country cottage for about 10 years and we had mains electricity and that was all. There was a school with a single schoolteacher - bearing in mind being conscious of your partner's profession - and it snowed every winter and, in fact, we were cut off every winter. In fact, there was one time when it was highly embarrassing, where we were cut off for 10 days, apart from a tractor which in fact brought the milk from the nearest farm to where we lived. So all that I was trying to get across was the fact that yes, we have quite a knowledge of metropolitan areas. It's not only me. Bob Somervaille - who is the other co-convenor - has for donkey's years had property at Blayney and spent an awful lot of his time out at Blayney.

MR BANKS: Okay.

MR HALTON: So there is an awareness and an interest and we've never in fact tried to make a fetish of this, but we've certainly - in a whole range of activities - tried to make sure there is a bit of a balancing act that goes on.

MR BANKS: Okay. Could I just clarify then that there is you and your co-convenor; are there any other active members of this working group?

MR HALTON: There are three or four members at the present time who, frankly, do not want to be named.

MR BANKS: Right, okay.

MR HALTON: It is their preference.

MR BANKS: All right. They are living in rural or regional areas as well.

MR HALTON: Yes.

MR BANKS: Okay. Good, thank you.

MR HALTON: I should say I have to apologise that Bob Sommervaille hasn't got here today. He was in his garden pulling up weeds just over a week ago, he lost his balance and fell quite hard onto his back and bruised it heavily and he's been told he is not to get into any mode of transport until he gets over it - otherwise, Bob would have come.

The other thing I have to do really at the beginning is in fact ask you whether we can have a copy of the transcript of this session as soon as possible. I've got to say, yes, I heard what you said to the previous witness, but for reasons which relate to what I was outlining earlier, we have been quite concerned about the fact there are still over 4 million Australians who do not have access to the Internet and what have you. We were talking - some years ago now - to a former chief executive of what at the time was called Telecom Australia, and he reminded us - and it's before my time, so it was a new comment - that in fact there was also a plateau that occurred in the acceptance of the telephone in the 1960s and there was a small but fairly vocal group of people who said, "Look, until this is dealt with we are not going to use the telephone." That apparently worked. This is a modest attempt to do something similar.

MR BANKS: Okay. Are you saying that you're denying yourself access to the Internet until - - -

MR HALTON: Yes.

MR BANKS: Until what?

MR HALTON: The threshold we have talked about is a million.

MR BANKS: Sorry?

MR HALTON: A million. There are over 4 million at the present time. If you get it down to a million we think in fact that will definitely have got it on its way towards what we would describe as total acceptance.

MR BANKS: Yes, okay, but you don't have access to the Internet?

MR HALTON: No.

MR BANKS: We will be happy to send you a hard copy of the transcript.

MR HALTON: Thank you.

MR BANKS: I think they call it snail mail these days, so it will take a little longer to get to you than the previous participant.

MR HALTON: That is all right.

MR BANKS: Please, we'll give you the opportunity to - - -

MR HALTON: You've got a reasonably polished draft of a second submission from us and for ease of reference we've called the various sections in that B1, B2 and B3, just in the same way as the sections in what we gave you last May we called A1, A2 and A3. I have to say that the discussion drafts, both of the national competition policy and also of that other inquiry into liner conferences, arrived the same day. We don't have the resources to deal with both at the same time, so we opted to do NCP, although at least two of us have a very real interest in liner shipping. As far as I'm concerned I was not only - for the Australian government - a member of one of the boards at ACTA/ANL for nine years, so I know something about it from the inside, but I also know a certain amount about tramping and we were disappointed that we weren't able to do both, but we had to make a choice.

I think the other thing I've got to own up to at the beginning is that if it hadn't been for Ross Gittens - who you may recall demonstrated he could read 400 pages in 36 hours and do his copy for the Sydney Morning Herald on Saturday, 20 October - that we might not have made it anyway, because in fact we were under a certain amount of pressure to do something on aviation in another quarter. But when, from reading Ross, it was obvious that something was coming up from you characters in the very near future, we said to the people who wanted us to write about aviation, "Sorry, NCP is more important."

MR BANKS: We would like to think that Ross read all 400-odd pages, but we'll hear from him on that.

MR HALTON: Yes, sure. You'll remember that when you first put out your issues paper, on page 4 it said:

> A great deal of work examining NCP implementation and its impacts has already been undertaken. The commission will not seek to replicate this but will draw on available material in undertaking its analysis and

arriving at its findings.

Frankly, we interpreted that in a different way to what we have subsequently learnt you intended it to be. We thought that, amongst other things, you would have asked the commission staff to undertake an issue search from earlier submissions, you see. So it was only when we got to what you'd done in your discussion draft that we realised you hadn't done that, so a lot of stuff that we would have put into end of May, we ended up ramming in - in a curtailed fashion - to what we did for you in December. That's why at the very beginning there is a list of contributions we've made to earlier inquiries, where we think there is material which is relevant to what you're trying to do in this inquiry.

MR BANKS: Yes. I should say that we will selectively use submissions that went to earlier inquiries if they're drawn to our attention in the context of the current one, but you'd appreciate that when five years goes by it's not always possible to believe that, with a submission that was made five years previously, the various members who put that submission together would necessarily want that to be information currently available to the review, so I guess we err on the side of drawing on inputs that are made to the present review unless something else is brought to our attention. Apart from anything else, we do get hundreds of submissions as well, so I'm sorry if there was some misunderstanding about that.

MR HALTON: We all live and learn. I should say, in terms of the references we've put in, we haven't included material we've done for the ACCC or for the NCC or for what is now IPART, but we have included Tim Besley and Dick Estens, because we actually thought a lot of what was in those two inquiries was really quite generally useful, applicable to the type of issues that your inquiry is involved with. We said it was a draft firstly, because that gave us a chance to find out what you were going to want to talk about today, plus the fact that we wrote to a number of bodies asking for clarification on certain issues. We've had responses on some matters, we haven't yet had responses on others. But, in fact, we will, at least within a day or two, meet what we understand is your current drop dead deadline. Has that changed because you're now going to Perth?

MR BANKS: What I'll say to you - it's going to be on the public transcript, but people know it anyway - is that our deadlines are never absolute because if you send us something, even the week before we sign off, we'll look at it. The problem is that - you know how these processes work - to do something justice, we need time. What we are saying is that a submission that gets to us by the end of the year will serve that purpose and give us adequate time to produce our final report which, as you know now, is due at the end of February.

MR HALTON: That's helpful. As I say, we will certainly do our level best to

respond in that time frame. What I was going to suggest to you might be most useful from your point of view is not for me to try and cover the waterfront in terms of what we've recently put to you and what we put to you last May but to really touch on about four of the broad issues that we've highlighted. I don't expect you to agree with everything we've written but I thought that, if I tried to deal with those briefly and, as it were, stop at the end of each of them to give you a chance to come back at me, that might be the easiest way of covering this material.

MR BANKS: All right, that sounds fine. I should say that the whole purpose of these proceedings is not to have everybody agree with us. It really is to learn from different points of view.

MR HALTON: Other people's perspective, sure. The first one is actually B1 in the December submission and a considerable part of A1 in what we wrote to you last May, because from our perspective, reading what's in that discussion draft, we don't feel you've actually really responded properly to your terms of reference. If I deal with the two sections which we've highlighted, which are section 4(a), which is very specifically related to national competition policy, and section 6, which is this requirement that you really go out and consult widely around the country. From our point of view, and using as our benchmarks what we drew attention to last May in the approaches which were followed by Tim Besley, John Cosgrove - in what became PC number 8 - and Dick Estens, we feel that, in fact, there are fairly large gaps in the Australian community who have a serious opportunity to consult with you and you to consult with them.

If we just look at publicity - and obviously we've looked more carefully at New South Wales from this point of view - we can't actually find much evidence that, in fact, places like Harden, Parkes, Blayney, Orange and Oberon even know that this is going on. We've done things like checking with local ABC radio, because we would certainly from our experience say, in fact, ABC radio is one of the major ways that those communities do find out what is going on.

When we look at what you list at the end of this discussion draft, really we don't get a feel that there's much in the way of focus groups or roundtables - there was one in Wagga, we'll grant you that - which looked at Australia as Australia. We found it interesting. John Cosgrove, before he got to his draft report, had five months. In five months, he generated 195 submissions. You actually got to six months before you produced that draft submission, and I'm obviously as aware as anybody about some of the factors relating to the timing of the election, but in six months you got 136 submissions. So in terms of pro rata, you did half as well as John Cosgrove did. We just have a feel that, in fact, it's heavily skewed to eastern Australia and it's heavily skewed to major centres.

I agree that the big interest groups - I have heard a couple of them this morning; I'm not sure whether I would categorise them as enormously big, but they were nevertheless key interest groups - do tend to be located in places like Canberra, Melbourne and Sydney, but we certainly felt that you were thin on the ground. I wouldn't expect you to agree with that, but we wouldn't be, as it were, giving you a feel of what we've got out of it if I didn't say that.

MR BANKS: No, that's fair criticism. In a sense, we were relatively thin on the ground compared to the review in 99, largely because we're doing a different task. You'll recall that the review in 99 was specifically about impacts on rural and regional Australia. That really necessitated wide-ranging visits and dialogue with people in rural and regional Australia. That is still present in the current terms of reference, but it's subsumed in a much broader task that we have. That partly explains why we haven't held a public hearing in Harden or even had a workshop in Harden. We did do one in Wagga and, indeed, we drew on not only rural New South Wales for that but people from Victoria and other places came. We had people from Newcastle and so on who attended that, so we had a fairly wide range. It wasn't intended to be all-encompassing.

The other point I should make in relation to the media is that we have had quite extensive coverage in the media, including through regional radio. We track what happens in the media. I could go through this on the record, but it would take me a long time. But we have had pretty extensive coverage. Admittedly, a lot of that coverage has occurred since the discussion draft went out, but also we had a certain amount of coverage at the time of the issues paper. Also, while we didn't put advertisements in every regional newspaper, we did have advertisements in the main state dailies which I think you'd have to argue - - -

MR HALTON: What would constitute as the state daily for New South Wales, for example?

MR BANKS: The Sydney Morning Herald. The Australian, I think, is a national paper which - I've got a place on the South Coast as well and they seem to have a lot of Australians there, when they can get them, and people read them. We read our local paper mainly to find out what's happening with the local council, which I think is quite important, but people who are interested in wider issues will tend to pick up those papers.

The other point I'd make, I suppose, in terms of the number of submissions we get, my experience has been with our inquiries that we get the most submissions for the most focused inquiries. For example, an inquiry that we've currently got into the smash repair industry is inundated with submissions. Most of them are confidential but it's been inundated with private submissions. When I did an inquiry into private

health insurance we got a lot of submissions. But when you do something that covers the whole economy, in a sense, the interest becomes a bit more diffuse; partly because they know that you're not, in that inquiry, able to address their particular problem or grievance.

So that's I think another possible reason why we've had fewer submissions. That being said, we have had quite a wide range and, as you indicate, it hasn't just been from the big end of town. We haven't had a lot from individuals, I admit that, but that tends to be the case, other than in inquiries that touch individuals in a way that they feel obliged to respond; and private health insurance was one such inquiry. As soon as you mention NCP, a lot of people's eyes glaze over and the thought of getting any submission out of them is quite hard.

The other point I'd make is that where we have scheduled hearings and roundtables on topics of even particular interest to rural and regional Australia, we've had a hell of a time drumming up interest in attending those. I suppose with the taxpayers' money in mind, scheduling a hearing in a place, taking four people there, flying to regional Queensland or somewhere for perhaps one participant at a public hearing is probably not a good use of money; so we do have to bear that in mind.

MR HALTON: Well, it's a good use of money if in fact that's the only way you get a perspective from that particular interest group, isn't it?

MR BANKS: Well, I suppose that individual - if, for argument's sake, it was only one person - can always write to us and indeed if they put their hand up we might even fly them to Canberra to appear. So, look, I am responding. You didn't expect me to agree with you and I don't entirely agree with you but I suppose just to explain what we have tried to do in this process. It can always be done better. I've been doing work on the report that we do on indicators of indigenous disadvantage, and it strikes me in that project too that you just cannot consult enough. There's always more consulting that you can do, but I guess within the limits of our resources and the time available, and the breadth of this topic, we have done our best. But as you say, perhaps we could have done a bit better.

MR HALTON: Okay. Well, then, the other half of what we call B1 was we have a feeling that in fact you have difficulty in coming to grips with clause 1(3) of the agreement. On one hand we can understand why that causes problems, because we think it's looser in terms of what first ministers wrote down in the first place; because they were, from our perspective, deliberately trying to in fact say, "Well, there are a number of what you might describe as clearly prescriptive issues that must be addressed, and then there are a whole range of other issues which may or may not in a particular situation be relevant. So we've got to in fact put them in so that nobody

can accuse us of leaving them out, and also the people who judge these matters in future years will not have the excuse of saying, 'Well, it wasn't written down, therefore we don't need to deal with it.'"

So when we looked again - and we made more or less the same comment in relation to what John Cosgrove did - when we looked at clause 1(3), we really thought there was an opportunity to do more than we felt you had. Just to try and avoid saying, "This is all terribly woolly, and give us a few examples, Charles," we thought, for example, if you went back to those three comments on the 1999 modelling of regional impact, there was one in the middle of the three which was done by John Fallon, where he looked at some of the issues relating to Queensland dairy reform.

We felt that in fact in his critique, he provided a number of quite helpful hints about how it would have been possible, with longer time and depending on what you were trying to achieve, to get further into what you might describe as - well, what did happen in that case where there was something going on which really had, you'd have to say, almost catastrophic effects to an industry sector in rural Australia, rural Queensland; and were the effects actually as catastrophic as that, or was the amelioration which it was possible to achieve doing a lot to make it less worrisome than it appeared? It did seem to us - and frankly, we've had this one ticked for five years almost, because we thought it was an interesting comment that was being made in relation to a critique of some of the commission secretariat's earlier work to, yes, okay, you could come back and do something quite useful in relation to, well, how does at least one part of clause 1(3) work.

Then we also thought we'd throw two others at you which in fact, in a sense, more directly affect governments as a contractor. Down in Eden, in the last two or three years, there's been a munitions wharf built. From your old work, Philip, in the explosives area, you'll remember a bit of what went on on that; and the munitions wharf has been built and a depot associated with that munitions wharf is now operational. Now, there was certainly a lot of triumph when, at quite a late stage in the whole process, somebody demonstrated that you didn't have to go to Malaysia to get the rubber fenders to actually put on that wharf. There was actually a source that you could use in Australia. But the whole question of in fact whether sufficient attention is being paid to the ability of industry in that part of Australia - as opposed to industry in Sydney - to work on that project, at least from our point of view, is debatable.

There's another project going on at the present time which is still in Bega Valley Shire, just to make it monotonous, between the shire council and the state government. A totally new sewage treatment system for the shire has gone through its feasibility study. Contracts have just been let, and in fact - because I've been

saying to the shire council for about five years, "Look, you can do a lot more of that locally than some people will tell you." Initially, the council was saying to me, "Yes, we think we've more or less achieved what you were talking about, Charles," so I said, "Okay, will you let me use this material at this forthcoming hearings on NCP?" Yesterday I got a letter back saying yes, but also actually hedging the bets rather more than previously as to how much is actually being done locally.

I've not had a chance to read the attachments that have now been given, but it is certainly my intention after I've talked to my colleagues to give you some material on that which is a different type of example to the one I was talking about a minute ago, but it is really related to the issue of where does local government and state government go in relation to the application of national competition policy within particular parts of its territory. I don't know what I'm going to be saying at the end when I've read all the paperwork, but it did seem to me - and talking to my colleagues, we agreed - that we ought to, in fact, run a couple of those issues at you along the lines that, yes, clause 1(3) is difficult because it's woolly, but it's not impossible. From our perspective, in reading the material this time we don't feel that you've given it as much weight as we would have thought was justified.

MR WEICKHARDT: I'm sorry. I might be being sort of stupid, but I've missed the point about your Eden example and the rubber buffers from Malaysia.

MR HALTON: That, in fact occasionally, probably the Commonwealth has not given sufficient guidance to its own officers to really give as much weight as they could have given to using local industry, which has some things going for it like wage rates down there are significantly lower than wage rates in Sydney which in fact would be beneficial to the local community and also beneficial to the overall cost of the project. That type of argument.

MR BANKS: At one level I think clause 1(3) - we'll be talking about, broadly, the public interest considerations as very relevant to the review that we've done. We have covered the areas picked up in there, but more through our own terms of reference which ask us - and our own act which requires us to look similarly at the impacts on the community and adjustment effects and so on. The work we've done, again because our work has been so wide ranging we might not have been able to get into the detail in our research that would inform some of the individual legislative reviews, for example. There were 1800 or so nominated and each one was using this as a template.

At the level at which we've dealt with it, I suppose, we tried various levels of aggregation and industry's perspective to get a sense of how the costs and benefits line up. Obviously we haven't satisfied you in that endeavour, but I think you'd have to agree that at least we've tried to get a sense of what the effects have been in

distributional terms, regional terms and also even on small business. We've got some further work under way to get a sense of what some of the income distributional effects have been through the modelling that we're doing, which is a very hard task actually to achieve. So, again, we'll look at the criticisms you've made and if we can improve that - including by looking back at John Fallon's work, which was again specific, I think, to how we would approach the dairy industry case - but, nevertheless, if there are some lessons in it for us we'll certainly take them on board.

MR HALTON: Right. Thanks. Then I'd like to go to what in our December submission is B3. What that ended up with as a title was actually a fair reflection of the frustration of one in particular of my colleagues when we first started drafting it. As you've probably noticed, it starts off by saying, "Was it really necessary for the discussion draft to rewrite recent history?" The reason why it provoked that opener was because of the way it laid out in the relevant section things that had changed, considerable credit appeared to be being given to what had happened in the 1990s, although from the point of view of some people who you might think are accused of being insiders, we would say from our knowledge of transport, telecommunications, broadcasting et cetera, had really been going on since the mid-1970s.

In fact, it was partly because when we read Helen Owens' report on user charges cost recovery, which of course was sourced out of Melbourne, we thought quite a lot of what we had been talking about would have got in, whereas in fact in the discussion draft it comes across as all this started to happen in the 1990s. Those of us who had been working methodically in transport and communications et cetera from the mid-70s would say that really the last 10 years wouldn't have happened if you hadn't done all the earlier work, the foundation.

We had Gordon Mills from Sydney University - who incidentally my wife had worked with when he was in the Department of Economics at Bristol University and Shirley was their tame statistical adviser - coming in, working with all the states and the territories and the Commonwealth on user charges cost recovery et cetera. We had been going quite methodically through that for a very long time. In addition, when you get into the section, which is 3.3, on determinants of Australian productivity revival, there is a comment made on page 41 and there is more elaboration a couple of pages later: "in the absence of a technological advance specific to Australia".

Actually we think it wasn't the fact there was a technological advance; it's the fact there was a technological failure that is the significant difference for Australia, because if you think about the mid to late 1980s there was a quite determined push to develop what these days would be described as a home-grown PC industry and that fell flat on its face. Sorry, I said 80s. I should have said late 70s, early 80s. That fell flat on its face by the early 80s. IBM, although they were under considerable

pressure from government in this country to take that electronic typewriter facility in Wangaratta and start to produce PCs or PC components in it in about 83, 84 - Brian Finn said no, he wouldn't.

If you look later in the 80s you have a situation where all Australia's equipment was being imported. Later on when the tech bubble burst, actually that did not have the bad effect on Australia - because we hadn't got a home-grown industry - that it had in other countries in South-East Asia as well as in the United States and the UK et cetera. So we would say that there was a difference between the environment in Australia and the environment elsewhere. I know it doesn't exist now, but I can still remember in about 1984 when John Monaghan was still the commissioner at the Public Service Board, before he went off to be the auditor-general, my recollection is he organised a series of meetings in the orange building, as it was, to talk about how you could use all this gear which we were starting to import.

That was well received by departments like DSS, which had been playing with mainframes forever, and departments like communications and transport, which had got a whole range of process controllers - small mainframes - but some of the central agencies which really hadn't had any experience were remarkably cold at the time. As somebody said to me the other day, it wasn't until the coordinating agencies realised that this was a potential bonanza in relation to efficiency dividends - if you can remember all that - that they started to take it quite seriously.

We think that, in fact, really there is more to that story than you provided. One of the reasons why in B3 there is a bit of a homily about the Ferranti Pegasus process controller is not because - although I had a lot to do with it from Bristol in the 50s. It's a nice illustration of how Australia did, in fact, use process controllers in what for the time was a quite sophisticated way, but then Australia had moved on when other countries had not moved on. I can remember going to talk to the Central Electricity Generating Board in the UK in, I think it was, about 93 when they were still using a bank of Pegasus computers, whereas on the Snowy we'd already gone to our first SCADA system control and data acquisition system before the end of the 80s.

The reason for that comment about SCADA in relation to what is going on in the ACT is that actually the Mount Stromlo water treatment plant is now at this very moment at the final stages of commissioning. When it's commissioned they will run the whole of that system with one controller down Lower Molonglo sewerage treatment plant. I wondered whether, in fact, a couple of you might find it interesting just to see what is being done.

MR BANKS: Could I say again that the question of the role of IT in all of this, I think, is an important one and it may well be something that we need to say more about. We have a whole stream of research in the Productivity Commission which

has been directed at looking at the role of ICT - information and communication technology - in the productivity revival that may be of interest to you. We've actually tried to quantify some of that.

Certainly, what has happened in Australia, I think, is the uptake of information and communications technology has been extraordinary, at least through the 90s, and I'm sure the antecedents of that occurred at an earlier time. The other part of it that I think you're alluding to is the terms of the trade benefit we got, in a sense, from being able to import relatively cheap equipment which is good.

MR HALTON: Yes. That's right.

MR BANKS: With the other participants in mind, I should perhaps indicate I think we're using up a little bit of their time. If I could give you 10 more minutes, will that be sufficient?

MR HALTON: Okay, that's fine. B4 is about road infrastructure. Why that is in there is because, although for the last more than 30 years there has been a lot of concern about really how do you treat the cost provided by government in relation to roads, pavements and all the other stuff that goes with it, it really came to a bit of a head in the mid-70s, I think, while Philip was still overseas, when Jim Nimmo did that inquiry which led to Tasmania Freight Equalisation Services. One of the clear messages out of that was he was stymied because, in fact, there was no decent treatment of what really was the total investment in roads and how, in fact, did you treat it from an economic point of view.

It's not that there weren't isolated examples. Sydney Harbour Bridge is one fairly obvious one. The ferry over to Kangaroo Island is another which is treated as an extension of the road. If you go to Perth, the ferry which links Perth with South Perth is also treated as an extension of the road and gets paid for. It's not that there weren't examples, but really it's the point that it's not been able to be tackled because nobody knew how to start to charge.

Coming out of the application of what is old defence IFF - identification friend and foe - which has been around for 50, 60 years, now with transponders you really can do it. In fact, if you look at the common protocols which have been agreed to by all the state, territory and commonwealth governments, it really is possible to start looking seriously at how you might charge for road usage, which we've never been able to do before. We didn't have the vestige of a pricing mechanism. We do now. I admit we don't have it in a very comprehensive manner, but certainly if you think, for example, about what Singapore has done, if you think about what the City of London has done and you look at some of the tollways in North America, there is a real possibility.

But before you do that, you've really got to rework a lot of the studies which have been done - and they're in that B4 section - to look at how you might best assess the cost of all this infrastructure and the cost of the use of that infrastructure, including the cost of casualties, both to people and to equipment. You really are talking, and have been for many years, 15 billion plus a year on that front. So it's not peanuts you're on about. We think that's something about which it would make a lot of sense for the Productivity Commission to come in quite hard and say to governments, "It's time you faced up to it, because you now are starting to have a viable system which would allow you to talk sensibly about user charging."

I must say in the same breath that only this week I've seen NRMA back on the hypothecating fuel taxes line which I thought they'd been off for over five years, but they're back on it. Of course, they conveniently forget they don't approve of it for tobacco and they don't approve of it for alcohol but they do approve of it for fuel. That's enough on that one.

MR BANKS: Okay. Thank you.

MR HALTON: My final one is in B5. I really do think there is an issue, which - although it directly affects the structure of the Productivity Commission - is whether, in fact, the structures of the PC, the ACCC and the NCC are really appropriate for what task they are likely to have imposed on them over the next decade. I'm trying to cut it right down to the bare bones. I actually started talking about the lack of private sector economists when I first came to Australia at the time of Nugget Coombes' royal commission.

In fact, I can clearly remember that at that time there was only one private sector economist I talked to regularly and that was Howard Bell, who was then AMP's chief economist. He was the only that I really felt was talking practical language, apart from one or two like Fred Gruen in academe. But there really weren't many of them around in the private sector. Also it's fair to say that there was within the public service a much broader range of skills. Andrew Robb was on the radio about four years ago saying he felt the public service was now almost totally sourced from people who came out of metropolitan and large urban areas.

I promptly sent off to whatever the radio program was an extract from what we'd done to John Cosgrove, because we'd done some work on what you might describe as best practice in relation to statutory authorities, not only in Australia but in US and Canada and the UK, and we certainly were coming to a view that, in fact, there was something there that really ought to be chased, and times have changed actually. When I joined the Australian Public Service, we had a chairman of the Public Service Board who actually as a second-division officer, had served in

Echuca and served in Lithgow. He really did know something about the country. We haven't had one like that for a very long time.

So section B5 is saying to you, as the commissioners doing this inquiry, that one of the things you ought to think very seriously about is suggesting that the structure of the Productivity Commission ought to be revisited. From my perspective - and I know my perspective is not necessarily yours - the PC grew out of the Industry Commission, grew out of something, grew out of something, and in many ways it is a development of the same basic animal over 40 or more years, and it would be timely. It's not being put to you as a huge criticism of the commission but it would be timely.

When I turned up, there was a Bureau of Transport Economics. After a while, it became the Bureau of Transport Economics and Communications, then it went back to being the Bureau of Transport Economics. It's now the Bureau of Transport and Regional Economics. The Productivity Commission is the one which is closer, from our perspective, to its original form than any of the others. It would be timely to think whether it ought to continue like that into the foreseeable future.

MR BANKS: All right. I value your experience and perspective on that. I suppose in our defence, or my defence, I would say in relation to this particular inquiry I was very careful to choose two colleagues representing business and social welfare perspectives to complement my own background. It's impossible to get people who represent everybody and, indeed, I think there are downsides to having commissions that are representative because the whole purpose is to have people who don't have vested interests and so on. In terms of the constitution of the commission, you may be aware that, in getting the Productivity Commission Act through, an obligation was placed on the government to appoint commissioners with particular skill sets, covering the environment, covering social welfare delivery and covering business.

In a sense, the government - or, indeed, the parliament - has already imposed some changes on the commission which I think distinguishes it perhaps from the past, where it may well have been a bit more homogeneous. The only other point I'd make in relation to private economists is that I think there has been a blossoming of private consultancies, although, like you, when I read one of those reports I always think, "Who paid for it?" I suppose one advantage of the commission and the statutory independence that it has is that you know that the taxpayer paid for it, through the government; that we have a constitution that can protect our independence. We have views, like everyone else, but we test those views in the public domain and you are never quite sure, when a private economist writes something, what might be behind that.

Just in relation to members of this particular review team too, I can assure you

I did a quick check. We have members of our research team who were born and bred in the bush and others whose family are still living in country Australia, so we do have those kind of personal connections as well. But it's an important point and something that I guess the government, and I personally, give a lot of attention to in terms of appointments to the commission.

MR HALTON: I think you are probably more sensitive about the use of private sector research groups than I am. Sure, I became a public servant in Canada after quite a lengthy period in the private sector in the UK, and my first appointment was actually as director of science and technology to the spanking new Canadian Transport Commission. From the very beginning, we did use research workers of all disciplines who came from the private sector. Sure, it may be my background that makes me more sympathetic, but I was never conscious, either personally or the people I was working with, of really being nervous about whether the jobs we commissioned were being slanted to meet our requirement. Sure, there was a lot of attention paid to who we awarded contracts to - - -

MR WEICKHARDT: At least you knew the question you asked them.

MR HALTON: Yes.

MR WEICKHARDT: Sometimes when you see the reports you're not quite sure what question was asked originally.

MR HALTON: Yes, I accept that.

MR BANKS: But certainly we make use of consultants quite a lot, as you will see in our annual report, and indeed we have associate commissioners appointed from time to time to bring that kind of perspective, but thank you for those observations. Thank you for attending the hearings today. We look forward to the final version of your submission coming, and thank you again for the earlier submissions that you made.

MR HALTON: Pleasure, and I apologise to the people who are supposed to follow me for holding the mike up.

MR BANKS: They've probably been enjoying the discussion, so thank you very much. We will just break for one minute.

MR BANKS: Our next participants are from Enertrade. Welcome to the hearings. Could I ask you, please, to give your names and positions.

MR BERRY: Certainly. Good afternoon. My name is Luke Berry and my position is manager of regulatory and compliance at Enertrade.

MR BANKS: Thank you.

MR BERRY: I have with me Angela Moody, who is a senior regulatory analyst at Enertrade.

MR BANKS: Thank you very much. Thank you for attending today. We have a submission in response to the draft. I don't think you provided one in the first round.

MR BERRY: That's right.

MR BANKS: But thank you for this one and I will give you the opportunity to highlight the key points.

MR BERRY: I might start by saying just a few words about Enertrade. We are a rather odd beast, I guess. We are a Queensland government owned entity. We sell electricity, and I guess financial hedges in the wholesale energy market. We essentially operate and dispatch six power stations, all located in Queensland, as well as having an interest in some gas transmission pipelines. Today we were really looking to discuss the Productivity Commission's draft discussion in respect of generator market power and, in particular, the comments at around pages 169 to 173 of your draft discussion paper, which really looked at whether such market power existed and perhaps whether there should be some sort of a public policy response to it in the context of the ongoing NCP reforms.

What I proposed to do today was just make some introductory comments, really highlighting some of the key points in our submission, and then take it to a question and answer format. As an introductory point, I should note that Enertrade was involved in the regulated infrastructure forum paper that was written by NECG and was quoted in the submission. I wouldn't propose to go in depth into what that submission says. It's probably more eloquent in its expression than I could be, but I would generally support the views in that paper and, I think, in particular the view that markets subject to the normal protections in the Trade Practices Act in Part IV; that markets should determine efficient capital structures, and that is likely to lead to the most efficient outcomes.

In that context, we would be concerned about an intervention, an MCE-style review that might lead to an intervention, in particular in the electricity wholesale

market that might restrict otherwise efficiency-enhancing arrangements, cross-ownership type arrangements that could be otherwise taking place, subject again to, say, section 50 of the Trade Practices Act and the conduct provisions in Part IV as well.

I guess we probably thought that it would be highlighting some of the instances where an intervention of the style that the ACCC is advocating, which is some sort of a super merger, super anti-merger power, or other sort of similar provisions, might negatively impact the wholesale energy market. We will do that, I guess, later on in the points, and we have done in our submission on 10 December. Perhaps I should start by saying a few words about our general view of the effectiveness and efficiency of the wholesale electricity market, meaning the NEM. Enertrade's view is really that that market is working reasonably well; certainly as well as a number of other markets in Australia.

It's generally an open market where there is lots of transparency, lots of available information for new entrants considering entering the market through the SOO, the statement of opportunity, and the ANTS process. So certainly there is a lot of information out there for new generators, new transmission companies, to use to decide whether or not to enter that market. When you look at the average prices that tend to pertain in that market, they have generally trended downwards significantly since the start of the NEM and they have also tended to converge, as you would expect, across regions, which is a sign that interconnection is providing a source of price equalisation subject to what could be expected to be the constraints that are always going to arise in any market.

When you look at the prices that are out there, you're getting prices - looking at the 2002, 2003, 2004 prices - generally below $35 a megawatt hour, sometimes below $30 a megawatt hour, and those sorts of prices are low, and arguably could even be below the sort of sustainable prices that you would need in a market in the longer term. As a general view, we would say that there is on an oversight from a higher level. There doesn't appear to be a significant instance of price gouging or of high prices due to concentration of power amongst sellers in the market.

In that context, we would generally see the merger activity that is going ahead, and in particular, for example, AGL's stake in Loy Yang, as a natural response to the market - to taking a risk position, a particular risk position, in the market. It's also, I guess, partly a consolidation arising from some overseas buyers deciding to return to their home markets for whatever reason, and we wouldn't see it as a further accretion of generator market power. Obviously, also we would point to the significant transmission investment that has been going on as also evidence of increasing opportunities for generators from interstate to compete in new areas, and that further enhances the competitiveness of the market.

That is something that has tended to be downplayed by some commentators, and yet when you look at, for example, the Loy Yang case, there's clear evidence there of the court accepting the national, or at least the east coast nature, of the National Electricity Market. Thus, when assessing generator market power, it's clearly appropriate to look at the full suite of generators operating from South Australia right through to the tip of the north of Queensland. So that's our general view about the market. I think just on top of that, we would argue that the market is also evolving, and it's probably evolving to a state of greater competition, in the sense that post-restructuring and corporatisation in the market in the mid to late 80s, there was a situation where there were a number of larger generators; say, in New South Wales, three major generators.

Over time, with strongly growing demand, you would expect more generators to move into the market, potentially allowing for a greater diversity of ownership; also a greater mix of peak mid-merit and base-load supply in efficient response to the shape of demand in the market. That investment wave is really occurring at this time and is likely to result in greater diversity of ownership in the market going forward. There is a range of new generation in Victoria, New South Wales, Queensland, and it's likely to result in greater diversity of ownership going forward.

So it's probably, from that point of view, premature at this stage to be looking at specific conduct or structural responses to a perceived concern of market power, particularly where that concern relates to perhaps one jurisdiction, the most commonly cited being New South Wales, where it's generally accepted that the market is a national market. If there were accepted to be a problem in New South Wales, then the response would be a New South Wales-specific response, such as, for example, the New South Wales Treasury proposal to look at tendering out the risk elements of trading, which would essentially result potentially in greater diversity of ownership, irrespective of the physical ownership of the plant in New South Wales. So I guess they are some general points.

MR BANKS: Did you want to maybe respond to a couple of points the ACCC has made on those matters?

MR BERRY: Yes.

MR BANKS: In fact, you may want to look at the transcript from yesterday where they talked at some length, I think, about the special features of electricity markets that they thought predisposed to market power.

MR WEICKHARDT: Indeed, you may have already seen it, but they tabled with their submission, or appended with their submission, a few papers that they have had

prepared - one by, I think it was Darryl Biggar - looking at incidents of price spikes and the underlying reasons for withdrawal of capacity, which among other things cited profit maximisation as a reason for withdrawing capacity, which would seem to me a fairly prima facie indication of somebody playing.

MR BERRY: I haven't had the benefit of seeing that paper in particular. I think I saw the general paper, but I haven't had much opportunity to have a look at that, and also a Frontier Economics paper, which I think was appendix A from memory.

MR BANKS: Yes, that's right.

MR BERRY: When I looked at the Frontier paper, the terms of reference for that were really very specific to the ACCC: how do you apply a notion under section 50 of a substantial lessening of competition? It didn't really come to grips with the issue of whether or not there should be some sort of special industry-specific power. It was more about other merger guidelines and the safe havens in there; a sensible approach within that particular industry. So I didn't really see that particular paper as having too much relevance to a recommendation to review whether or not to perhaps extend the ambit of section 54 for generators in particular.

MR WEICKHARDT: They actually stressed yesterday that they were not talking about - I don't know whether this is a recent sort of view - a modification to section 50.

MR BERRY: Right. No, I'm not sure if they would be looking at something like special sections like there are for telecommunications.

MR WEICKHARDT: They cited the airports legislation. Again, you would want to read the transcript. I don't want to put words in their mouths, but they cited that, I suppose, as one example of what has happened in another industry.

MR BERRY: Probably our general view is that, once you've got that sort of legislation, it would be difficult to sunset it, and you might well find that it interfered with the operation of the market and the natural evolution of the market from a relatively competitive to a fully competitive model, and might well have some deleterious effects. It would depend, I guess, specifically on the nature of what was put forward, and really, there has been very little specificity from the ACCC in terms of what would be put forward. Really, it seems that the ACCC's comments came out of their loss in the AGL Loy Yang case, and so it's difficult to know what the industry has to respond to; what sort of proposals would be on the table.

I note that in that context, the industry, I think, would be worried about a review because you would expect that it would be something that would take a year.

The MCU would be seen as quite a political body and is quite a political body obviously. The process would take a year, result in some recommendations going to governments that might well sit there for another six or 12 months, and the industry sits there wondering - and in particular, new entrants sit there wondering - what is going to happen. When they enter the market, will they potentially be forbidden from forming relationships as new generators with retailers? It's likely that the new entrants to the market will be the most likely to be deterred by the process of a review going forward. Existing entrants: well, they're already stuck in the market. There's not too much they can do. While there is new investment going forward, and the ultimate shape of the market is still evolving, it's probably not timely for there to be a review at this stage by a high-level political organisation of the structure of the market and whether or not things should go forward. It's probably a good time really to let the market get on with its processes.

Having said that, there's probably - in terms of, say, responding specifically to the notion that there are price spikes, that they're a result of market power. I could probably make some general comments in that regard, although they wouldn't be specifically in response to anything that Darryl Biggar might have written. I think our view on that would be probably the same as the NECG paper by Henry Ergas about, "Has the NEM failed?" that was prepared in about 2002.

The fluctuations in the market are generally evidence of supply and demand changing over time. Obviously they change more rapidly in the electricity market than some other markets, and therefore prices change more rapidly. But those price signals are useful as an indicator of the sort of new generation that needs to come in. If overall prices are high, then you would expect base-load to come in. If you get needle peaks, then you would expect a peaking plant to come in. If you tried to somehow suppress the market in some way to reduce the volatility in the market, then you could well alter the nature of a new investment that's lured into the market, away perhaps from peakers to base-load.

MR BANKS: What about the view that some might put that some of those peaks reflect market power in themselves, and therefore represent a strategic barrier to entry for, say, peaking plant investment - in other words, they would be making an investment predicated on prices that may not apply after they've entered, because of what the incumbents might do strategically?

MR BERRY: The AGL case looked at the issue of whether or not there was short duration market power, perhaps because of transmission or generation failures. The view taken there - which we agree with - was that generally across the day, and across the season, and across the year, there is no market power. There might be some very short duration market power because a major generator collapses, there are constraints on transmission wires, and that results in a level of market power of

short duration for a half hour or for an hour or two.

There are a range of processes that currently exist to address concerns about that sort of market power. The NECA currently has a role to investigate, monitor and to examine market prices. They have a role in terms of examining whether or not generation has been withheld from the market strategically, and that sort of a role will continue with the new governance arrangements. So for example the AER will have the ability to obtain search warrants, the ability to compel people to make statements, and it's similar to the powers of ASIC in relation to the share market. There will be a wide range of powers to ensure that those sorts of price-gouging exercises aren't undertaken. Those sorts of specific narrowly targeted powers that the AER has - or NECA has and the AER will have - are probably a good response. Of course, there is also potentially and more broadly Part IV of the Trade Practices Act. If there's a view that there is some abuse of market power, section 46 applies.

So I guess those are all mechanisms for dealing with market power. The other view is that a lot of the ACCC's analysis is predicated on the special nature of electricity and its instantaneous nature, and the precise matching of supply and demand that must occur at any given time, and also the demand elasticity of electricity. The market is undertaking a range of developments that over time will probably reduce those aspects of electricity, but they're not special features of the electricity market. They might be perhaps to some extent a greater feature of electricity, but there is a range of markets where there are far less players than there are in the generation market, especially if it's accepted that it's a NEM-wide market, and where there are relatively high inelasticities, and yet there aren't proposals on the table for potentially extremely intrusive measures to combat those sets of arrangements.

MR WEICKHARDT: There aren't many markets that I know of where prices can go from $50 to $10,000 in half an hour, and the whole market instantaneously be aware of it.

MR BERRY: Yes.

MR WEICKHARDT: So it is an unusual market.

MR BERRY: It is unusual in that sense. On the other hand, there are probably not too many markets where the prices can go from 10,000 back down to 50 in the next half-hour, or alternatively there aren't markets where prices can go to minus $1000. There are not too many markets where suppliers so clamour to supply users that they're prepared to pay negative $1000 per megawatt hour.

MR WEICKHARDT: I regret to say I came from an industry where occasionally,

in the chemical industry, products were often sold at negative prices, because you just had to get rid of them, so I think there are a few other markets like that.

MR BERRY: Just to expand on that point, the instantaneous nature of electricity, and the fact that you've got heavy supply-side inelasticity, particularly for the base-load power plants with very low ramp rates and minimum generating requirements means that at times of low demand there really is a fight to the bottom to get to dispatch power. There's a whole set of arrangements around the interaction of wind and base-load power and who backs off whom and there's a whole set of arrangements around NECA enforcing noncompliant energy and so forth that are really designed to address that. They're really refinements of the code without the need for a heavy-handed thumb-on-the-button approach from the ACCC or some other body.

MR WEICKHARDT: I think philosophically the ACCC's position is not a million miles from where you are. I think if they could be satisfied there was a truly contestable competitive market which didn't require heavy-handed regulation, they'd be very happy, and probably most of their users would be. I guess what everyone is wrestling with is whether we've got to that stage yet.

MR BERRY: Yes.

MR WEICKHARDT: The point you make about the fact price signals should attract new entrants is true if the entry barriers are low, but one of the scenarios that's painted - and I think Rod Simms recently wrote an article about this, and it's a big distance from where we are today - is if you got every generator lined up perfectly in terms of capacity with every retailer, entry barriers would go up very considerably, and it would then be very difficult for a new generator to enter the market. So I guess there are understandable concerns about, you know, could you suddenly get this market that you've tried to create contestable elements in reaggregating in a way that was dangerous. So it's a question of sort of looking before we get there, I think.

MR BERRY: I guess so. I don't think that the market is evolving to that extent. AGL is taking a 30 per cent stake on a base-load generator. A lot of other retailers have reacted very differently. Some retailers in Queensland have taken an approach where they wanted to try to control the output of some power stations but others are happy with hedging arrangements. The danger, I guess, with some sort of interventionist approach is it could have the precisely opposite effects than were intended, really. It could actually impact the hedge market. For example, a proposal to disaggregate portfolios of generators - which was one of the possible views put on the table for, say, New South Wales and to a lesser extent Queensland - could increase, as we say in our submission, volume risk; the risk that, as a generator, you've taken a hedge position that you can't meet because of unexpected outages at

either the plant or in transmission wires.

That sort of a risk is probably minimised for a company like Enertrade, with six plants, by having some geographic dispersion to avoid transmission outages and having six plants, I guess, so there's a wider portfolio of plant to call on to cover hedge positions. Smaller generation units basically don't have that diversification benefit; could be at greater risk; may be more reluctant to enter hedge markets. That's one of the concerns that we have about, say, the impacts of potential re-regulation of what national competition policy said was a contestable market, and where there's probably not been a lot of evidence produced of substantive concerns of market power.

MR BANKS: One of the arguments the ACCC has made is that the interconnects aren't really capable of creating a fully functioning national market, and I don't know whether you want to comment on that. I think the point they made yesterday - and it may not be economic to try to have them so large that you would do that because of the cost relative to the benefit of that. Do you have any observations about what's happening with the interconnects?

MR BERRY: There's certainly been substantial investment, and there's continuing to be investment in interconnects between the states. In a sense, that's caught up in the broader question of what are the regional boundaries. Logically, the regional boundaries are drawn to separate areas where, between them, there are constraints. I guess there's never going to be a market in which there's no level of congestion, but there's certainly been significant investment, and a national market is more and more emerging day by day, compared to the situation that we perhaps faced in the late 90s. That's really a process that should be allowed to continue, would be our view.

At the end of the day, if there were more money spent on interconnects, the point of congestion would shift perhaps intra-regionally and, obviously, there are some intra-regional constraints at the moment. I think we would generally agree with the AGL case that, yes, there is some binding of constraints, and Enertrade would love to reduce the constraint binding on QNI because we could send more power to New South Wales when it's hot, like it was a couple of weeks ago, but we don't see that as evidence of market failure. I think that's probably going too far.

MR WEICKHARDT: Their point was, theoretically, if you had pipes so thick that the market could go anywhere, you'd be very relaxed with a market structure of one generator per state. Clearly, that's not the position we're in, so it is a hybrid market, part national and part regional.

MR BERRY: Yes, that's right, and you also get intra-regional constraints that can create some pricing anomalies as well, but congestion is equivalent to scarcity.

That's what the science of economics is all about. How do you ration scarcity of resources? There's no way to abolish it; it's just really how you react to it in the most efficient way.

MR BANKS: Another element of that - and you just made that comment, you know, when it was hot you'd send it - is that when it's hot in New South Wales it's often hot in Queensland as well.

MR BERRY: Not necessarily, though, no.

MR BANKS: That was what I was going to ask you; to what extent you get coincidence of demand peaks which nullifies the scope of the interconnect to equilibrate.

MR BERRY: Yes, you can do, but the other day when the temperatures hit 40-odd degrees in New South Wales, they were much lower in Queensland, so there was significant temperature diversity. There's a whole range of factors that drive demand as well - the industrial base and so forth - and so you can get non-coincidence. But I guess that's a bit like a stadium with a major sporting event; there are going to be times when there's huge demand for cars to drive on roads to get to those stadiums and then there are going to be times when there are very few cars on the road, and that's really ultimately more a matter about how much generation you build.

The code has a set of arrangements which impose a very low threshold or, if you like, a requirement that unserved energy is 0.002 per cent of energy demand, which means that you get, in Queensland, 10,000 megawatts installed for peaks of 7000 megawatts in the middle of the hottest part of summer. Even in that context, there's about another, let's see, 1200 megawatts being built to come online within the next three or so years. So there is - and this was a point made in the Frontier paper - a lot of new generation being built and it's because of the signals under the code to ensure that unserved energy is very low, and that loose supply demand balance means that there is effectively another competitor sitting out there at all times.

MR WEICKHARDT: You mentioned the New South Wales situation in two respects: one is you said, "Well, there's going to be greater diversity." Of course, that would be a good thing. There's nothing more of course stopping the three generators that have a significant chunk of the lowest end of the cost curve at the moment being the ones that expand, which wouldn't create that diversity.

MR BERRY: Yes, except I think New South Wales's green paper said they'd prefer private investment.

MR WEICKHARDT: Yes, obviously that would be infinitely better.

MR BERRY: Yes.

MR WEICKHARDT: The other issue that you referred to is the decision to lease out the trading arrangements. The ACCC said that New South Wales had recently released a paper changing their stance in that area. Have you seen that, or are you aware of that?

MR BERRY: I don't think they've made a final commitment whether or not they would do that. A view on whether or not that's a good idea is probably not something that we would really want to comment on today. I guess we raised that in the context of - look, there are, you know, a broad range of solutions to specific problems in specific jurisdictions and anything in the way of legislation that was NEM-wide, and wouldn't probably tend to sunset, would be the sort of provisions that would not be properly targeted to the nature of the problem.

There really hasn't been a proper identification of the problem. That means that there are real dangers in a review because it would sort of toss around a whole range of possible solutions and spook investors at a time when there is a whole range of new proposals coming forward and result in a lot of uncertainty for the year, or two years, until a review was held and the recommendations of the review were considered and debated and digested and accepted by governments.

MR WEICKHARDT: That's a remarkably similar view Henry Ergas was putting about the telephone industry.

MR BERRY: Yes, I think it is. The point I'd make about generation is that it is far less concentrated than telecommunications. It's meant to be a competitive market. There are not the same level of vertical linkages on either. Because of very strong demand now and going forward, there is allure for a whole range of new players to come into the wholesale market at the generation - and hopefully, with more full retail contestability - at the retail level. So, yes, there is a lot going on. There are also a whole lot of issues in terms of reform of the code and reform of the reg test that the ACCC has had its hands on recently.

In some ways it's a little bit ironic for the ACCC to be pointing to constraints on the interconnectors between states, when they set the rules that govern the level of investment in those, and arguably they've set the rules too low, compared to what a lot of the generators and other market participants have pushed for, so it's a little bit ironic.

MR BANKS: Could you just elaborate on that point?

MR BERRY: They probably haven't fully recognised the competition benefits from building interconnectors and so, as a result, potentially there could be less investment than there should be in transmission, because the case for building it just can't be made compared to localised generation.

MR WEICKHARDT: I think they have to consider, don't they, under the provisions, whether that's the most efficient way of that capacity being delivered to the market?

MR BERRY: Yes.

MR WEICKHARDT: I guess, in theory you could argue it was more efficient to build a local generator but, as you say, if you were a man from Mars you might say, "Well, there's a better outcome here. There's an interconnector that could be built quite quickly and has other benefits."

MR BERRY: Yes.

MR WEICKHARDT: It certainly seems to have been very slow to get some of these interconnectors in place.

MR BERRY: Yes.

MR BANKS: And you mightn't have to be from Mars. Were there other points you wanted to make?

MR BERRY: I have some speaking notes here. I don't think we have very much departed from them actually, but I think that's the point. The general point really that a review would be potentially perceived by the industry as in itself a regulatory risk, is probably something we've touched on. That's a point that can't be stressed enough. Really the push from further regulation in this area has come from the ACCC out of its loss, and they'd probably quite agree in terms of the Loy Yang case. There has been a range of moves in terms of the changing of governance arrangements in the wholesale market to move away from centralised ACCC control.

The potential outcomes of a review would be really to enhance the ACCC's powers, or to give them some industry-specific powers that they wouldn't otherwise have. In view of the decisions to decentralise and to move away from a central power with the ACCC could well discourage some investors because they would see a reaggregation of regulatory power with the ACCC and they'd seen the review as potentially throwing up those options. So they'd be reluctant to invest whilst the whole process was going on, of a review.

MR BANKS: I think one of the things that might have motivated us, at least at the time we were drafting this discussion paper, was that we saw there may be regulatory risk the other way, and that is while the ACCC was holding back waiting for an opportunity to appeal - and it confirmed that yesterday - that there is regulatory risk being generated anyway which was one of the points we made, but obviously it can go both ways.

MR BERRY: I think it can. Our view - and there was a discussion I think at about page 173: look, there's uncertainty, let's resolve that once and for all, through a review. There are a couple of problems there: one is that it is to be reviewed by the MCE, or under the MCE's supervision, and the MCE in terms of all the governance arrangements, has been saying very carefully, "Look, there needs to be some high level political direction to the regulators, but we need to make sure that we step back as far as possible from being perceived - especially given our ownership interests - to be trying to orchestrate or control the market."

So we don't want to be seen to be conducting reviews of this sort, because it could be perceived as furthering the interests of particular players in the market. We want to remove the regulatory risk. We want to remove the political intervention in the market and have governance arrangements which give some surety to the market participants about that. The best way to do that probably wouldn't be a review in this case. Yes, that would be our view.

The other point really is that where there is a review that is ordered that could come down either way, the unhappy party or parties tend to want to build up pressure for a further review to contest the outcomes of that review. Alternatively, of course, they could go to the parties that ultimately decide on the matter - the governments - and seek to influence at that stage. I can't really see that a review that would be conducted by the MCE would be finally dispositive of the issue. It's probably an issue that would come back again and again.

Perhaps the clearest way to send a signal that a review is - you know, to resolve the uncertainty, is to simply say, "Look, there shouldn't be a review. There hasn't been a case made out that there is an evil in the market that needs to be confronted," and that we need to find a solution to an identified evil. There's been some broad discussion about potential problems but there really hasn't been a clear identification of real problems in the operation of the market.

MR BANKS: That section 50 couldn't pick up?

MR BERRY: Yes - I mean the general provisions under Part IV, particularly section 50, couldn't pick up. There's a broader point that, how can you justify industry-specific legislation as well? I think that point has been well made by others.

MR WEICKHARDT: The ACCC's point which resonated a bit with me was that section 50 was all designed to prevent mergers of the substantially lessened competition, and they said if you don't have a competitive market to start with, section 50 really is fairly impotent in terms of if you've gone from uncompetitive to uncompetitive.

MR BERRY: Yes. I would have thought that if you, say, had an uncompetitive market and there were only two players and they sought to merge, section 50 would probably prevent them from merging because it would still point to even less competition in the market and probably would substantially lessen competition in the market.

MR WEICKHARDT: I'm not a lawyer and I won't express an opinion, but I guess I could understand logically what they were saying.

MR BERRY: Yes. I mean, I also probably don't accept the general view that there is an uncompetitive market here, that there are such special characteristics about electricity, or that there is such a small number of players in the market that there's a lack of competition.

MR BANKS: Okay. It's been a really helpful discussion. Thank you very much for it, and thanks for the submission.

MR BERRY: Thank you.

MR BANKS: We will just break for one moment, please.

MR BANKS: We will resume now with the Energy Retailers Association of Australia. Welcome to the hearings. Could I ask you to give your name, please, and your position with that organisation.

MR RUSSELL: Good afternoon and thank you. My name is Deane Russell. I'm the executive director of the Energy Retailers Association of Australia.

MR BANKS: Thank you very much for attending today, also for the two submissions you provided, one before the draft was released - back in June, I think - and one since. As we discussed, why don't you raise the key points with us and we can respond.

MR RUSSELL: Thank you very much for the opportunity to speak today and I appreciate the short notice and the support of the commission. There are several main points I want to make, then just focus on one in particular. The energy retailers' main objective over the next few years is to seek extension of full contestability for all customers around Australia - that's one of our major goals - when there's appropriate benefit shown for that in some sectors of the market.

We're after additional appropriate institutional and governance arrangements and we spell that out in our submission, and efficient and consistent national regulatory and market framework, and a phasing out of retail price regulation, and that is the particular issue I'd like to talk to this afternoon.

The ERAA believes it's particularly important that prices efficiently signal the need for customers to adjust their consumption patterns in response to changing supply conditions, and for also producers to invest in new capacity. We believe if regulated prices are duly suppressed, the longer term sustainability of supply could be compromised and ensuring low-income users have adequate access to power and other services is best handled through transparent community service obligations, rather than the general suppression of prices, and I'll touch on that in a minute.

The Productivity Commission's discussion paper suggests the MCE could play a useful role in exploring ways to improve the efficiency of retail price regulation with particular emphasis on facilitating the responsiveness of both demand and supply. The ERAA does not accept that price regulation remains a legitimate and ongoing role for governments to facilitate consumer protection goals, a full decade after reforms began and perhaps three to four years of full retail contestability.

So let me just emphasise that point. There have been some suggestions that where state governments are regulating retail prices, that a way forward may be for the MCE and indeed maybe the new AER and AEMC process to administer regulated prices. Our premise is that regulated prices should not be the role of any

government agency and/or commission, for now or in the future, and obviously in our submission to the Productivity Commission on energy efficiency we talk specifically about domestic airconditioning use and consumer behaviour without receiving pricing signals. I don't want to go over that particular issue, but we were quite strong on that point and I'm sure you can look at the figures there and see what's actually happening in the market with the domestic airconditioning users and prices.

Just to summarise our point, to even suggest that prices should be regulated where prices in the wholesale market are not regulated, we feel that state governments are regulating prices for social outcomes. While we accept that the energy retailers and indeed the energy industry has a social obligation, we believe the prices are not transparent and there's a lot of cross-subsidisation still going on, and in our submission on energy efficiency we show where there's a non-airconditioned home in New South Wales is cross-subsidising to the tune of $70 a year for an airconditioned home. So even to suggest that retail prices should be capped, we think there should be more transparency for lower income earners and vulnerable customer policies and specific hardship policies for specific groups of people.

The presumption that a retail energy market will not be effectively competitive is an admission that the competition reforms in the retail sector have failed. This does not appear to be backed up by any evidence of market failure in jurisdictions where competition has been introduced. So there's a premise around that governments should regulate for competition. We believe that you can't regulate for competition, that it needs to be more open for the full effectiveness of competition to flow through.

We would urge the commission to establish a timetable for the jurisdictions to review the effectiveness of retail competition in the context of identifying and addressing market failure as a priority, with the objective of removing retail price regulation when the current price paths expire. We do not support the transfer of retail pricing to a national regulator. Further, priority should also be given to establishing and addressing transitional and distribution impacts of national competition in a targeted and transparent manner as discussed.

I just want to make a couple of other points. The ERAA recognises that governments may wish to pursue social equity and/or affordability issues, and we understand that and we have a role to play in that. To the extent that governments identify these issues, they should be addressed not through price control, which inhibits competition, but through direct and transparent government payments. We think there's already systems in Australia in which we support low-income earners or people at risk or vulnerable customers. The challenge of course is what is the definition of a vulnerable customer: are they generally low-income people who are

long-term unemployed, who cannot afford housing, have difficulty paying for food? You know, they have a whole range of other social issues.

The retailers are not the Department of Social Security. In some states they think we are the Department of Social Security. When you look at an energy bill, there's a component in the bill obviously for generation, there's a component for transmission, there's a component for distribution and there's a smaller component for retail, and yet some state governments see the retail arms of the industry as the ones that should be paying for people who cannot afford electricity.

We would argue that a person who is vulnerable may be in particular hardship because they've lost a job, they've been unemployed or they've had a death in the family; there's an illness, where they are unable to pay any bill, let alone a utility bill. The industry already has hardship programs in place where people can't pay bills. They approach the retailer, there's a payment methodology; in some states there's a coupon based process where NGOs and that type of thing help and support disadvantaged people, and we think that's a better way to go, to have a more transparent process.

As a transitional measure towards the removal of price regulation, the ERAA welcomes moves made in some jurisdictions where full retail contestability has been introduced towards a light-handed form of regulation of retail prices for residential and small business customers, for instance in Victoria, and gas for New South Wales. At the conclusion of these price paths after five or six years, ERAA expects the retail energy market will have a strong competition and considers that jurisdictions should not continue with price regulation.

We do go on in our submission to talk about further reforms that are needed, but generally I think that the AER-AEMC process is working well. I have supported the bureaucracies in the federal government and the state governments with the notion that I think everybody is working with the best intent of trying to come to terms with that new body; how it may more efficiently regulate and manage the market. Of course, distribution and retail are not coming on till 2006-2007 and we're already engaged with all the parties to try and smooth some of that regulation through.

I don't want to talk about those issues but to highlight that to be an energy retailer in Australia requires you to get a licence in each state, and that is a barrier to entry for new market entrants. I've made that clear to the MCE process and I think there is every intent to try and work through and eventually, at some stage, come up with a single national retail licence. I didn't want the commission to dwell on that in particular, but I think if you look at the history of competition for the energy market in Australia COAG made certain noises about competition and pricing. MCE then

went on with that, but for some reason everybody wants to open competition up for everything else except for prices. We think that's not sustainable in Australia. That's the end of my formal part.

MR BANKS: Is your concern with the transition to deregulating prices or, rather, that you're worried that under the current arrangements you won't get to that point at all?

MR RUSSELL: Every state is in a different phase of transition to what I would call more open competition with their pricing. That's mainly for political reasons, I think. So you might have quite an open market in Victoria, leading down to an even more open market, and there are 14 retailers in Victoria. They're offering not only prices to specific markets but they're offering bundling gas, bundling IT, bundling telephone, et cetera. So there is a range of benefits for competition in there that's quite difficult to point to prices in particular.

I mean, how do you measure competition? The South Australian regulator has come up with a set of criteria, including things like churn; the number of times customers change retailer. So there has been some work done on how you measure competition in South Australia and Victoria, for instance, and we think that's reasonably robust and is moving down a path. The challenge, of course, is for the other states where there are political concerns, and the challenge for any political party is security of power; in other words, the lights not going out over reasonably low prices for consumers.

If I could make another point, if you look at the way in which the market has been developed in Australia, one might argue that, because we move from quite a monopolistic state government owned industry to the industry being broken up and efficiencies being made, that forced a downward pressure on prices because it was naturally broken-up; you had competition, you created efficiencies. You know, generators were running their business better - Coles and Myers, retailers, et cetera. What I think is happening is that the supply side is coming through now. So we've gained all the price efficiencies we can out of the industry and you're now seeing a fairly rapid increase in the degree of supply in Australia, or the demand for supply.

Obviously, there have been examples about how quickly Queensland's demand is growing because of domestic airconditioning and industrial growth. The natural growth in the Australian economy has been strong. People's consumer patterns are changing, the way in which they consume energy is changing. So the demand for energy will go up. If I could make a point on that, there has been a lot of talk by regulators to come up with new regulations to try and create competition in the market. For instance, in New South Wales there is a suggestion that there might be a demand-side management levy introduced that will go into some kind of kitty that

will start to pick winners for demand-side management. We don't think that's appropriate.

We think that the issue has to be tackled on two parts of the equation. One is you have to create efficiencies and a benefit for people to make savings on the demand side. That's either curbing or flattening out loads, giving people a benefit. Retailers already do that for customers - will pay people to turn things off when the price goes up in the market - but on the other side of the equation you have to have more efficient supply. So you have to send pricing signals for that, whether it's people going to introduce coal base-load or they're going to develop more gas-fired power plants for peaking which are closer to market and that type of thing. We think that needs to be open competition, not regulated for.

MR BANKS: You talk a bit about market failure in the sense of, you know, before intervention occurs there needs to be demonstrated market failure. I think we'd have to agree with that, but do I get the implication in here that you don't see there is any market failure at all in the energy sector. Any potential for market failure?

MR RUSSELL: I suppose there is always potential, but what I'm saying is that the challenge for Australia in policy development is that regulators are making decisions on issues affecting the market which have five and 20-year ramifications, and not often do governments articulate a policy position for a regulator then to make regulations about. We think that the regulators are trying to create a market by regulating it, rather than governments articulating policy.

Let me give you an example. The Victoria regulator has announced a roll-out of smart meters or interval meters for domestic consumers over a period, so presuming there is going to be some kind of pass-through to customers, directly or indirectly. Where is the policy in Victoria enunciated that points to the benefits of that? In other words, if you have a whole lot of smart meters that you're getting data on half-hour blocks from every consumer in the state, are they going to change their behaviour? Presumably, they will get pricing signals so that the price will change throughout the day as the demand changes, but are consumers actually going to change their behaviour because the price goes up? I doubt whether people will run around and turn things off and on.

In our previous submission to the energy efficiency we show that the average household in Australia spends $2.55 a day on standing energy. Even if there was a 50 cents a day increase in their energy costs, are they going to change their behaviour and turn airconditioners off and pool pumps off at the same time? Technology has to go hand-in-hand; education for consumers; pricing signals. There is no one silver bullet for either the demand side or the supply side to overcome this issue. That's one of our premises as well.

Just to summarise, the Victorian regulator has ruled that mandatory roll-out of smart meters for domestic consumers. We're not against smart meters. We're only in favour of it where there is a demonstrated benefit, an economic benefit. So millions of dollars are going to be spent on smart meters and we don't think there has been enough work done in that area to determine whether there is a real benefit for the economy as a whole. So you're going to get all this data in from consumers in half-hour blocks.

There are simpler ways of sending people pricing signals; in stepped tariffs, you can have different tariffs throughout the year, you can have different classes of tariffs and that type of thing. Retailers will go into different areas and offer different prices, different products and that type of thing. For instance, if you have smart meters and domestic roll-out, what's to stop a new entrant coming in, cherry-picking all the really big consumers with swimming pools, airconditioning, whatever and then leaving a different class of customer that has a different load profile and a different risk profile? Then you end up with a whole lot of vulnerable customers, because there is cross-subsidisation going on. Those things haven't been thought through carefully, in my view. I'm not criticising the regulator, I'm just saying that there needs to be some policy thought through about these things.

MR BANKS: Okay.

MR WEICKHARDT: I've read your submission and I understand it. I guess the point the ACCC made yesterday - which I think I accept - is that, if the NEM itself was fully competitive, probably the ACCC and state governments would be much more relaxed about taking all price regulation off at a retail level. It's if you have concerns that the NEM itself may be vulnerable to having market power exerted, and I think if I was running my airconditioner and I was exposed to vol at $10,000 a megawatt hour I'd turn my airconditioner off for that half hour. The degree to which I guess the ultimate retail price might reflect the pool price - I don't know exactly how all that is going to play out.

MR RUSSELL: There are several points to make. First of all, we are not suggesting for a minute, as energy retailers, that people turn their airconditioners off. What we are saying is that you have to provide an incentive to change and modify their behaviour. What's the incentive? There is a price incentive. There is technology around now that will send a ripple down the utility lines and turn things off automatically - whether it's the pool pump, the hot water or whatever - leaving the airconditioner on.

Overseas people pay a lower price all year because their airconditioners are set at 23, not 21, and there are significant savings in the two degrees temperature, so

we're not suggesting that prices are the only solution. What we are saying is that there's a basket and that you cannot pick one winner that will solve this problem, or this issue, and flatten out the load. We're not suggesting that people are going to run around their houses turning things off and on and we're not suggesting that people pay $10,000 a megawatt hour either.

The interesting thing is that there are some generators who are now opening up retail arms. It will be interesting to see what happens with prices when Basslink opens. One of our members - Origin - even though it's not part of the retailing business, has announced a major base-load gas-fired power plant in Victoria. Presumably, they have done their homework and there's money in it for them to enter the market.

MR WEICKHARDT: I think they've announced that they're looking at it. I don't think they've started building it.

MR RUSSELL: No. That's right.

MR BANKS: Thank you very much indeed.

MR RUSSELL: Thank you very much.

MR BANKS: We will just break for one minute, please.

MR BANKS: Our final participant today here in Canberra for these hearings is the Australian Shipowners Association. Welcome to the hearings. For the record, could you please give your name and position.

MR GRIFFETT: Thank you, and good afternoon. My name is Trevor Griffett and I am the manager of policy development and labour with the Australian Shipowners Association.

MR BANKS: Thanks for attending today and also for the submission which you have provided and which we have had a chance to read. I will give you an opportunity to outline the key points.

MR GRIFFETT: Thank you. I will seek over the next few minutes, if I may, to touch upon the broad aspects of it. I won't delve into a lot of the detail, you having had the opportunity to read it, and we can explore that in some more detail if you so choose.

MR BANKS: Yes.

MR GRIFFETT: The brief for the Productivity Commission - and, in particular, the scope of this current further review of national competition policy - was particularly encouraging to the owners and operators of Australian shipping. It is perhaps useful to provide you with a very brief idea as to who ASA is and who the members of the association are, if you're not familiar. ASA has approximately 20 members, who represent the significant majority of what's known as "bluewater" shipping operations within the country, both domestic and international operations.

In that regard, there is the full gamut of nature of operation, owner-operators, managers, people who operate chartered vessels, owned vessels, LNG carriers, petroleum and product tankers, chemical carriers, a variety of bulk carriers, ro-ro's, container vessels - the full gamut of operations - so it's a fairly broad perspective in that regard to the nature of considerations in a review such as this. I indicated that the scope of this current review was particularly encouraging to ASA. The competition policy and its contribution to other policy goals really defined the focus of the recent independent review of Australian shipping, which was released about 12 months ago now, and it has continued to gain quite a degree of currency. It keeps bobbing up quite regularly.

That was a review commissioned by ASA, but it was very much independent on the part of former transport ministers, the Hon Peter Morris and the Hon John Sharpe, with whom we've had a long association in a variety of different forms and contexts. The concept of IRAS developed from the acceptance of Australian shipowners and operators, but circumstances had begun to combine in the recent past

couple of years to create an opportunity for a variety of different reform, industrial and economic issues to be put on the table quite openly for perhaps the first time in almost 20 years in this industry, and that was very much the case.

The reforms that have taken place in our industry over that period of time have been substantial, significant and noted in a variety of different areas. The concern of ASA is that perhaps a similar shift in the policy perspective of government has not moved in step with industry in its commercial reform and also in its industrial reform. Perhaps in that respect it goes without saying that in international shipping Australia is now very much operating in a global market.

Australian operators have ceased to see themselves as somehow separate from the rest of the international shipping industry. Rather, they look upon themselves now very much as a niche Australian sector of an international market. That's a fairly significant shift in perspective of operators. It touches upon the way they approach their industrial questions. It touches upon the way they approach their fiscal and economic arrangements and their financial arrangements as well. In many respects, it is a far different industry now than it was 20 years ago, than it was five years ago.

In order to access providers in these sorts of markets, we submit that Australian ship operators need to be unencumbered by the constraints inhibiting their ability to conduct their businesses in a way that is international best practice by definition; as I said, very much as part of an international industry rather than something which is quite geographically segmented. We noted then in the discussion draft that you have prepared that external developments prior to the late 1980s contributed to a deteriorating performance in a variety of different areas; high trade barriers; various regulatory and institutional restrictions on competition in the domestic market, which in turn sustained significant inefficiencies across the economy and, as the reform program of the late 1980s and into the 90s gathered pace, it became apparent that aspects of Australia's wider competition policy framework were impeding performance across the economy and constraining the scope to create national markets for infrastructure and other services.

Those comments may have been made in relation to an industry not specifically the Australian shipping industry, but there are very clear parallels, we would suggest, between those comments in those sectors and what has been occurring in shipping in the past number of years. There are two primary institutional and regulatory themes that we are finding regularly appear as we consider the policy settings that exist with regard to competition in Australia in recent times.

There are two themes that are causing increasing and ongoing concern in the

shipping sector, and those are that there's a series of legislative impediments that distinguish Australian operators only and inhibit competition by preventing those operators in this market from achieving a competitive edge through cost control, innovation and responsiveness to customer needs; secondly, the facilitated presence of foreign competition domestically in Australia's intermodal transport industry and the fact that the maritime industry is set apart from virtually every other sector and that it must compete within Australia's domestic and regulatory confines with that foreign competition operating also within Australia. That's quite a distinct and unique set of circumstances, but there are few other - and certainly in the transport sector no other - sectors that compete, certainly for domestic cargoes, in that same way.

MR WEICKHARDT: I guess it's directly analogous to a manufacturer competing with imports, isn't it?

MR GRIFFETT: No, I don't believe it is directly analogous. There is certainly international competition. There's no doubting that and that the Australian manufacturer out in the western suburbs of Melbourne or Sydney is certainly competing with, more often than not, an Asian manufacturer and the labour structures that are there and underlying the cost structure. The very significant difference is that the Australian operator in the western suburban suburbs of whichever state is not competing next door to an asset owned by the foreign competitor, nor are they working next door to the foreign labour on the foreign rates of pay. That's in fact what is occurring in the domestic transport industry.

MR WEICKHARDT: In fact, sometimes they're even worse than next door. If you've got a manufacturing plant in Sydney and you're competing with somebody from Singapore in Perth, the trucking rate to Perth is more expensive than the shipping rate from Singapore to Perth, so there are some cases where, in a manufacturing case, the guy is actually worse off than being next door.

MR GRIFFETT: Certainly, and that's quite a common example that's raised. Why is it more expensive to ship domestically on an Australian vessel than it is, say, to voyage charter a foreign vessel to get the goods from A to B? I think it's perhaps easiest to illustrate by actually using a land based example. For example, if you had a container or a load - let's just say a load - of goods to move from Canberra to Goulburn, I would suggest that the cost of transporting that load of goods from Canberra to Goulburn would be comparable to transporting it from Canberra to Brisbane. There are a number of circumstances that underlie that.

One is that the transport from Canberra to Goulburn is likely to be on a smaller carrier, a smaller truck, so there's less opportunity to defray the costs of operation, because it can only be defrayed over one cargo, whereas the goods transported from

Canberra to Brisbane are likely to be on a B-double and you might have two, three, even four different cargoes across which to defray those costs underlying the cost structure, providing a greater ability for a reduced freight rate.

The same occurs in the shipping industry, although it's compounded by the fact that you often have foreign fiscal and labour structures to compete with as well in that circumstance. For example, a product tanker between Far North Queensland and Melbourne only has that one cargo on the smaller product tanker to carry - a chemical carrier, for example - whereas you may have a foreign operator who's carried a domestic cargo into Far North Queensland or into Brisbane who is able to defray those costs of operation across its broader and longer distance journey on, more often than not, a larger ship with multiple cargoes.

MR WEICKHARDT: I wasn't necessarily, even in my example of Sydney to Perth, pointing a finger at shipping. I was just saying, if you were a manufacturer in Sydney of widgets and you want to sell them in Perth, you might be trucking them or railing them to Perth but it still might be cheaper for a person to have sailed them or flown them from Singapore to Perth.

MR GRIFFETT: Those circumstances will occur.

MR WEICKHARDT: There are situations where Australian manufacturers compete with somebody as if they're next door to them, almost.

MR GRIFFETT: Certainly. There are also a number of examples which unfortunately often tend not to get focused on in the same manner, where there are Australian operations that are, in fact, considerably more competitive than the foreign opportunities that exist as well for carriage. It's unfortunate that those circumstances don't receive the same sort of attention.

I should stress at the outset too that there are two things that ASA is specifically not doing in this submission. I think in terms of policy history surrounding these issues they are a significant shift. Those two things are that we're specifically not calling for a removal or a tightening of permit policy; what's perhaps loosely phrased as cabotage policy. We're specifically not calling for that. Secondly, we're specifically not calling for foreign-like fiscal assistance. Those are two things we're not doing.

In terms of seeking competitive neutrality within the industry, what we're actually seeking is that the legislative impediments that exist be addressed in a sensible and structured fashion. We see that as the most successful long-term structural assistance that could ever be provided the industry; that it will set the building blocks for Australian operators to be internationally competitive, whether

it's domestically or whether it's in international trades, because it will enable Australian owners and operators of vessels to act just like their competitors under international best practice circumstances.

A consequence of addressing those legislative impediments, I should say, will go a long way to overcoming the 2 to two and a half million Australian dollar per annum difference between operating an Australian vessel and a foreign vessel, because it touches upon a great majority of the structural circumstances that have a consequence of inflating Australian costs. There are 10 acts that we see as impeding that competition; at least 10 that we've been able to identify. The significant ones flow from the operation of the Customs Act and its treatment of vessels. There is no clear definition of what an international voyage is. There is no clear definition within the customs legislation regulations of what importation is.

A circular situation tends to evolve in that Customs look to the Department of Transport as to whether a permit has been issued. If a permit has been issued, then it's taken not to have been imported. Transport at the same time look to see where the vessel has been imported to determine whether a permit should be issued, and a somewhat circular situation evolves. The approach has been adopted that, because a vessel comes in internationally, at some point or another it will eventually depart. Therefore, it's not an international voyage and isn't imported. Given that we no longer have - certainly of the scale and magnitude of the vessels that operate these days - any production of those sorts of vessels in this country, arguably any vessel has always come from overseas and one day will eventually leave. That tends not to be the treatment for Australian owners.

As a consequence of the operation of the Customs Act and the importation of Australian vessels, those vessels then fall within Part II of the Navigation Act; become Australian vessels. Once they fall within Part II of the Navigation Act, there's a whole series of other pieces of legislation that hang upon that definition which then come into play, acts such as the Occupational Health and Safety (Maritime Industry) Act and the Seafarers Rehabilitation and Compensation Act, which impose upon Australian operators, but not their immediate domestic foreign competitors, a higher level of requirements over and above internationally accepted practices which, in some respects, with seamen's rehabilitation and compensation are virtually uninsurable in this country, certainly not insurable with the internationally accepted P and I club insurance and, with regard to the Occupational Health and Safety (Maritime Industry) Act, go over and beyond the International Safety Management Code, which is the internationally accepted practice for occupational health and safety internationally.

MR WEICKHARDT: Do those ships typically have to be physically modified to make them acceptable for Australian crews?

MR GRIFFETT: In some respects they do. It tends to come down to a greater level of administration, manning implications, additional tasks upon the crews which have flow-on effects to things that aren't done as a consequence of limited crew, limited time, ability to do other tasks. As an aside, with the additional security legislation that has come in in the last few months and the onerous tasks there - this doesn't touch upon competition policy per se but with the additional tasks there - many vessels are almost being pushed to sort of breaking point in terms of the administrative obligations that are now being placed upon ship's crews, that have been reduced over 20 years of reform in the industry, significantly less than international crews, for example.

The Migration Act comes into play as a consequence of a vessel entering in under the Customs Act, falling under the Navigation Act, looking at the visa provisions that exist for crews on foreign visiting vessels as opposed to the visa requirements for a long-term business stay visa, for example. The Workplace Relations Act - the high labour costs that exist in this country. There's a popular misconception that that's a consequence of union pressure in the country; that union pressure forces labour rates well above international labour rates. In fact, it's the Workplace Relations Act that drives it. It's an Australian workplace. The Workplace Relations Act demands that the provisions within that act take place and that they reflect community conditions. As a consequence, they do. Whether there is a range of variation in the EBA process over and above that is another argument that I won't go into here. But even at the safety net levels contained within the Maritime Industry Seagoing Award, they're considerably above and, in some circumstances, more than twice that of many foreign crews, and that's because they reflect Australian labour standards.

MR WEICKHARDT: What about productivity levels?

MR GRIFFETT: There are always going to be workplaces where there are concerns about productivity levels. That's no different in any industry, and there have been some highly-publicised ones over the past period of time. The reports that we get back from our members are completely at odds with reports that have appeared in the popular press over the last 12-18 months with regards to maintenance, with regards to the types of overtime work that some employers claim they have difficulties getting their crews to undertake.

MR WEICKHARDT: So manning levels would be comparable to manning levels on international ships?

MR GRIFFETT: The manning levels are certainly lower on Australian vessels.

MR WEICKHARDT: They're lower?

MR GRIFFETT: It's about 18, on average, on an Australian vessel and operating at around about 30 on a foreign vessel.

MR WEICKHARDT: That's a like-for-like type of vessel?

MR GRIFFETT: That's a like-for-like type of vessel. Some vessels have undertaken recently the process of putting riding gangs on board to do a lot of maintenance work. That's actually proving to be quite successful, because they're getting specialists in quite simply. They're putting foreign riding gangs on board ships to handle certain legs of the journeys and undertaking all the maintenance in one hit, and that's proving more economic than dry-docking a vessel, for example, and undertaking certain maintenance. So there are efficiency gains that are being explored in unconventional areas over recent years that are improving underlying cost structures.

I touched upon the Seafarers Rehab and Comp Act, occupational health and safety. To a lesser extent, the Customs Tariff Act comes into play, where there is treatment for certain goods. Foreign vessels that come in and depart again are exempt from those tariffs. Australian operators, for example, on mooring lines, where they're totally imported within this country, are distinguished from their foreign competitors within the same market.

The Shipping Registration Act is a key one. There have been two or three key policy proposals that we've been progressing over the last period of time. They have been the Shipping Registration Act and the Income Tax Assessment Act. We refer to those two as a process of retaining the business of Australian shipping and retaining the maritime skill base of the country.

The Shipping Registration Act mandates that any vessel owned by an Australian entity shall be entered in the Australian Register of Ships. That's arguably the least economic means of financing a ship, given that overseas finances - and it's almost exclusively overseas finances now in the maritime industry, because of arrangements they have placed in the various jurisdictions - determine what flag a vessel will be registered under. Australia is not amongst that list. That limits Australian operators' access to finance, for example, in many circumstances. If nothing else, where that finance is the only option available, it forces the business of the shipping out of the country, and there's a foolish economic rationale underlying that, we would suggest.

With regard to the Income Tax Assessment Act, we note that section 23AG of that act, because of an anomaly in the change in language of the legislation - the

modern drafting language that came in in the 1980s - as a consequence and quite contrary to the second reading speech to the bill, Australian seafarers operating internationally cease to be able to get the requisite 91 days to attract the exemptions. The clock stops every time the vessel moves through international waters, which they still are. It's hard to believe these days that there are areas of water which still don't have control of any particular nation, but there are. The clock ceases to accumulate the 91 days and, in fact, resets itself as it enters new waters. That has been determined by the Full Federal Court, and arguably they had little option but to adopt that definition. But it is an anomaly vis-a-vis foreign seafarers operating on foreign vessels within the domestic trades here, who are attracting like tax exemptions, reducing the overall gross cost of their labour to the foreign employer.

With regard to the Shipping Registration Act, it is perhaps illustrative to consider the flag nationality of the vessels granted CVPs over the past two years. Of approximately 265 CVPs - continuing voyage permits - issued over this period, the vast majority have been issued to vessels registered in Hong Kong, the Bahamas, Liberia, Malaysia and Cyprus. The next number following those - Singapore, Germany, Panama, Virgin Islands and Tonga - all have quite beneficial fiscal arrangements in place for their various fleets. I'll simply make the observation that section 287 of the Nav Act outlines a strict liability offence that:

> The master owner and agent of a ship commit an offence if any one or more of the master owner or agent engage in conduct and the ship is receiving directly or indirectly any subsidy or bonus from the government of a country other than Australia, or is to receive such a subsidy or has received such a subsidy, and the conduct results in the ship engaging in the coasting trade.

Section 286 specifically exempts permit vessels from being deemed to be operating in the coasting trade. So the legislation specifically exempts arguably the key protagonists intended to be captured by that offence provision, which seems to be an anomaly in many respects. The discussion in regard to permit vessels is not a new one. There are royal commissions dating back to the 1920s considering the exact same question, although back then it was concerns about tuberculosis coming into the country and whether the empire was going to dump all of its surplus sailing tonnage on the Australian coast, so the arguments really haven't changed significantly. In fact, the greater majority of our operators are quite reliant upon permit tonnage to supplement their carriage requirements and the peaks and troughs of those carriage requirements.

MR WEICKHARDT: Going back to the fact you said you weren't looking for any fiscal support, nor the end of cabotage or to change the cabotage arrangements, could you compete, if you got those 10 issues attended to in a way that offered a fully

competitive service, compared to a CVP vessel.

MR GRIFFETT: Most definitely. In fact, you touch upon in your draft discussion paper - and I make mention of it in our submission - that in terms of the operation of cabotage - I'm just trying to find the reference to it, but you talk about the manner in which cabotage operates and it provides a permit to a vessel where there is no Australian vessel available to carry the cargoes, and that's the correct manner in which it operates. What we would suggest is that there is no question that, in the circumstances that the underlying cost structure was able to be addressed through resolution of those legislative impediments - not in all circumstances, certainly not in all circumstances - there would be a far greater number of vessels available when that permit question is asked, because of a narrowing of the competitive gap, by addressing the underlying legislative impediments that bring about a higher cost structure.

MR WEICKHARDT: If that were the case, you're suggesting, I think, that you could offer a service which is much more competitive with rail or road on the long routes.

MR GRIFFETT: Not on all routes. We wouldn't suggest that it's a national sort of thing.

MR WEICKHARDT: Long routes.

MR GRIFFETT: Certainly on a lot of the long-haul routes. It brings into play also in that consideration the public benefit test that we touch upon; specifically, the contribution of our heavy reliance on foreign carriers of approximately $3 billion per annum towards a net services deficit, where even a nominal shifting in the numbers of vessels relied upon would have significant impacts upon the Australian fleet and a reduction of the current account deficit.

The latest figures we have for the 2001-2002 year talk about the contribution of foreign shipping to Australia's current account deficit of almost 14 per cent, because of our reliance on paying freight to foreign carriers in that period and, secondly, in terms of the impact on Australian investment, the significant reduction that has occurred in investment and shipping in Australia since 1995. The changes that occurred in that time perhaps only dealt with half of the question in terms of making the industry internationally competitive. They certainly removed a lot of the fiscal incentives that had existed in Australia, and there were a small number of those that existed at that period of time. What they didn't do was remove the legislative impediments to truly allow Australian operators to be competitive on an international best practice type basis.

We would submit that the impact of that framework should be viewed in light of that broad community impact, specifically in terms of those two headings, if nothing else; the impact upon the current account deficit and the impact upon investment in the industry. In terms of the shift towards other modes of transport, intermodally, the brief of the Productivity Commission is to ensure that Australian industry develops in ecologically sustainable ways.

I won't go into any detail, but certainly within our submission we highlight some anomalous shifts in transport mode choices over recent times where, in fact, whilst shipping supports over 29 per cent of the domestic freight task, it only consumes 9.6 per cent of the total energy used in freight and just 2 per cent of the total emissions from the transport sector and, in fact, there has been a shift in recent years. Whilst Australian shipping has managed a reduction of .8 megatonnes in CO_2 emissions - rail remaining quite constant during that period - there has been a shift towards road transport, whose emissions have risen almost six megatonnes over the same period of time, which is a somewhat anomalous shift in transport in terms of low-emission technology approaches over recent times.

Briefly, in terms of the presence of foreign competition domestically in intermodal transport, as I said, we see the maritime industry as set apart from virtually every other sector in that it has to compete within Australia's domestic and regulatory confines with foreign competition but under vastly different fiscal labour and cost structures. We note in our submission - - -

MR BANKS: Sorry, on that, would air transport be comparable, at the margins at least, where you have international carriers that are leased carrying passengers across Australia?

MR GRIFFETT: Yes, but not domestic passengers, and that's the thing.

MR BANKS: No.

MR GRIFFETT: In fact, it is interesting to note the debate that took place at the point of time in which Ansett closed its doors and, to deal with additional passenger demand in that period of time, Qantas sought to reposition a number of its Canadian planes with Canadian crews on board. In fact, they were actively prohibited from carrying domestic passengers that time and were put onto the international legs. Seen in parallel with Australian commercial shipping, those two approaches would seem very much at odds with each other, which is the glaring inconsistency that we would highlight.

We noted in your draft discussion paper the consideration of the road transport sector and the progress that had been achieved there, where it had historically

operated within a diffuse and inefficient regulatory framework, which imposed considerable costs on road users, and the similar and well-documented reforms in the rail sector. In that regard, we were encouraged late last week with the unique opportunity now presented to adopt a truly intermodal approach to competition policy, given - if nothing else - the words of the Hon John Anderson, minister for transport and regional services, in his second reading speech for the AusLink National Land Transport Bill in parliament last week, where he said that:

> The arrangements set out in this bill signal a move away from the longstanding fragmented approach to land transport investment, based on the needs of single transport modes and single jurisdictions. The bill will assist the change of investment focus to nationally important transport corridors and to finding the best solutions to transport requirements irrespective of transport mode and, through this bill, recognise the critical importance of links to our ports and airports in supporting a globally competitive transport system.

We see those comments as being quite consistent with the opportunities that exist through this review to support the underlying competitive infrastructure for the industry and what we see as impediments to realising that true competitive outlook at the moment, certainly in regard to AusLink, as it now appears to be progressing, and also with such initiatives like the Australian Logistics Council, who are likewise doing that. We see the opportunities currently before this commission as supporting very much, both directly and through the COAG process, those broader policy initiatives.

In conclusion, as I said, we see two primary institutional and regulatory themes; a series of legislative impediments distinguishing Australian operators and the facilitated domestic presence of foreign competition, which really exacerbates the impact of those legislative impediments, given effect through 10 interlinked pieces of legislation that combine in Australia to the detriment of Australian operators in an internationally competitive market.

MR BANKS: Thank you. If you had to unhook out of all those regulatory impediments the one or two that sort of stood out, which ones would you identify?

MR GRIFFETT: There would be three. There would be section 23AG of the Income Tax Assessment Act - that has an immediate need, given the need for retention of maritime skills - the Shipping Registration Act, so as to facilitate the retention of Australian business, and it's progressing slowly offshore. Over the last five years we have seen a not insubstantial reduction in the Australian flag fleet but, interestingly, over the exact same period of time we've seen a comparable increase in Australian controlled foreign flagged vessels. The total number, in fact, has

remained virtually static over the last five years. So what we are seeing is the Shipping Registration Act forcing business offshore. That further exacerbates the impact upon the net services deficit over time.

We would see the provisions of the Customs Act and the Navigation Act reviewed, and I don't think that there is a truly simple answer. A very simple change will have wide-reaching effects. I don't think that is a review that can happen simply, because a very simple change can have wide-reaching effects, whether that's addressing the definition of "importation of a vessel" or whether that is addressing the exemption of permit vessels from the coasting trade and the offences with regard to subsidies that exist. Both might achieve the same end but will have very different impacts at an enterprise level. This is something that needs to be considered at an enterprise level as well. The impact on trade is too significant with that, not only domestically but internationally as well. That it is a very sensitive consideration. They would be the key focuses..

MR WEICKHARDT: That has been very helpful. Thank you very much indeed.

MR GRIFFETT: Thank you for the opportunity.

MR BANKS: Thank you. I understand that there is a car downstairs as well, so it is probably timely to finish there and to thank you again for appearing and for the submission. We will adjourn the hearings here in Canberra. We resume in Perth on 20 December. Thank you very much.

AT 5.48 PM THE INQUIRY WAS ADJOURNED UNTIL
MONDAY, 20 DECEMBER 2004

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