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1 Introduction

The Tasmanian Government is committed to meeting its obligations under National Competition Policy (NCP) and has made very substantial progress in all reform areas including legislation review, competitive neutrality and monopoly prices oversight. Achieving this progress has placed considerable demands on resources within Tasmania's agencies as Tasmania has the same range of legislation as the larger states.

On 23 April 2004, the Commonwealth Treasurer issued terms of reference for a Productivity Commission (the Commission) inquiry into NCP, which will be used to inform the Council of Australian Governments' (COAG) review of NCP. The Commission's inquiry is to consider the benefits that the reform program has delivered to date and to identify new review and reform activities.

This document provides the Tasmanian Government's submission to the Commission's inquiry.

2 NCP reforms in Tasmania

2.1 Overview

The current NCP arrangements have assisted in bringing about some significant reforms in Tasmania and have helped create a more favourable business climate. In particular, the removal of restrictions on competition where they are not in the public benefit has increased economic welfare and contributed to the attractiveness of the State as a location in which to invest. The removal of all restrictions on shop trading hours is one very significant reform.

The most recent account of Tasmania's progress in meeting its NCP obligations is provided in the *National Competition Policy Progress Report - April 2004*, which can be obtained from website of the Department of Treasury and Finance at www.treasury.tas.gov.au.

The Tasmanian Government entered into NCP in 1995 on the basis that the arrangements are ongoing, including the competition payments. Tasmania has a timetable for future reforms, such as the rollout of retail contestability in the electricity market and contestability in gas reticulation. All assume a continuation of NCP.

Further significant economic benefits are anticipated from NCP arising from these energy reforms and from increased competition in other areas where legislation has recently been enacted, such as in the taxi and luxury hire car industry. Tasmania's ongoing commitment to the NCP national reform program has placed considerable demand on resources within Tasmania's agencies, and, without NCP alternative measures may have been adopted to achieve similar outcomes. However, NCP has assisted the State in meeting its objectives of attracting investment, generating employment and achieving higher levels of economic growth.

2.2 NCP and Government regulation

NCP has brought about major changes to Government regulation. The Tasmanian Government is committed to pursuing regulatory reform with the intention that the State's legislative and regulatory framework does not unnecessarily impede or restrict overall economic activity. Through Tasmania's gatekeeper arrangements all proposed legislation is assessed to ensure that legislation restricting competition or impacting on business is properly justified as being in the public benefit.

In the past, such legislation may have been adopted across all jurisdictions with little concern as to the potential impact on competition and, in many cases, without assessing the impact on business activities. Under the current NCP arrangements, whenever it is considered that proposed legislation contains a significant restriction on competition or a significant impact on business, the administering agency is required to prepare a regulatory impact statement (RIS) and conduct a mandatory public consultation process. This ensures that there is a systematic and transparent approach to assessing and documenting the impact of regulatory proposals on the community and acts as a deterrent to unnecessary regulation of markets within the State.

NCP has also contributed to the increased commercial focus of the State's government businesses. While many reforms were underway in Tasmania before the NCP Agreements were signed in April 1995, these have been assisted by the competitive neutrality and prices oversight requirements. As explained below, in the case of Tasmania's electricity sector, the structural reform required under NCP has contributed to substantially improved performance.

NCP also results in greater transparency in the operation of government businesses and significant business activities, though this is not made explicit in the Agreements. This is expected, over time, to lead to improved decision making as the full costs of these activities are estimated and made public.

For instance, the Government recently released a paper titled *Significant Business Activities and Local Government in Tasmania* which assists local government in identifying their significant business activities (SBAs). This paper will be used by local government councils to ensure that their SBAs comply with competitive neutrality principles.

The recent update of these papers has prompted councils to examine their activities in areas where there is competition from private sector providers. Services as varied as childcare and waste disposal are becoming attractive business prospects to the private sector. The full cost attribution requirements provide councils with the information to assess whether it remains appropriate and cost effective to continue to operate these services.

NCP has also brought about significant structural reform within Tasmania's electricity supply industry (ESI). Until July 1998, Tasmanian's ESI consisted of a single vertically integrated public utility - the Hydro-Electric Commission (HEC) that enjoyed an effective monopoly and was largely self-regulated.

On 1 July 1998, the HEC was structurally separated into three businesses: generation; transmission and distribution/retail. The structural separation of the HEC has enabled these three businesses to focus on their core activities and seek to meet their own corporate objectives. The very significant improvements in the returns to the Tasmanian Government, and therefore the Tasmania community, from these businesses over the past decade demonstrates the effectiveness of the structural reform.

2.3 Measuring the economic benefits of NCP

NCP is designed to improve the competitiveness and flexibility of the Australian economy and deliver higher living standards. Much has been achieved in the eight years since NCP was introduced and Australia is now experiencing the positive results of the implementation of NCP and other microeconomic reforms.

One benefit of NCP that cannot easily be measured is the change it has brought to the public policy process across Australia. The gatekeeper processes adopted by jurisdictions has resulted in policy issues being resolved with more focus on pro-competitive solutions than may have been the case in the past. While it may be possible to assess the impacts of some of the reforms implemented, it is never possible to identify, let alone measure, the benefits of governments not introducing measures that they otherwise would have. In Tasmania, all new legislation is assessed through the gatekeeper process in the Government's Legislation Review Program.

A further difficulty in measuring the economic benefits of NCP is that the effects of the reforms must be extracted from a number of complex and interrelated global and domestic supply and demand factors influencing the economy.

For example, legislation removing restrictions on shop trading hours came into effect in Tasmania on 1 December 2002. A supplementary review prepared before the introduction of this legislation found that the removal of restrictions on shop trading hours would lead to a substantial increase in employment in the retail sector. The review estimated, on the basis of detailed market research, that the removal of restrictions would increase employment in the grocery sector by 25 full time employees (FTEs) and 320 FTEs in the non-grocery sector, a total of 345 FTEs in the retail sector.

Since the legislation came into effect, employment in Tasmania's retail sector has increased by 9.1 per cent or 2 900 jobs. It would be difficult to estimate how many retail jobs were created as a direct result of the removal of restrictions, rather than as a result of other favourable factors such as population growth, increased consumption from higher aggregate employment and the sharp increase in visitor numbers.

Some significant benefits to consumers arising from NCP are not readily measurable. For example, a major benefit of the removal of restrictions on shop trading hours is the increased convenience to consumers, in terms of when they choose to do their shopping at the formerly restricted stores. Similarly, the reforms to the State's liquor legislation no longer require consumers to purchase a minimum of nine litres of liquor from certain liquor outlets. As these are non-market benefits, they are not easily measurable.

NCP reform has also been a key factor in the reform of the management and regulation of Tasmania's water resources. In 2000, the *Water Management Act 1999* commenced, which provided a more efficient policy environment for water resource management in the State.

Although the economic benefits to Tasmania from the implementation of NCP-based water reforms are difficult to quantify, the more integrated management of the State's freshwater resources since the implementation of water reforms has been of great benefit to the State.

2.4 NCP payments

The *Agreement to Implement the National Competition Policy and Related Reforms* sets out the details relating to the Commonwealth Government's undertaking to provide additional financial assistance to the states and territories, contingent on satisfactory progress being made with the implementation of NCP and related reforms.

The basis for the NCP payments, namely the return to states and territories of part of the taxation revenue gains to the Commonwealth arising from economic growth that can be attributed to the NCP reforms, is appropriate, particularly since the states and territories have undertaken the bulk of reform. It is also appropriate that these competition payments form a part of the Commonwealth's General Purpose Payments (GPPs).

The relevant Commonwealth taxes that have increased as a result of national economic growth are income tax, company tax and fringe benefits tax. In real terms (2002-03 prices), the aggregate value of these taxation receipts was \$112.65 billion in 1997-98 and is forecast

by the Commonwealth Government to be \$135.14 billion in 2003-04. This represents an increase, in real terms, of \$22.49 billion over this period.

NCP is one of several factors that have resulted in Australia's very strong economic performance over this period. As the 2003-04 Competition Payments Pool represents only 3.4 per cent of this growth in taxation receipts, this suggests that the level of competition payments is not inappropriate. There is certainly no basis for reducing the current level of NCP payments.

As the taxation benefits to the Commonwealth are obtained each year, transfers in the form of competition payments should be ongoing. Furthermore, the economic benefits of NCP nationally are yet to be fully realised. It is clear from the 2003 assessment of the National Competition Council (NCC) that many major legislation review reforms are outstanding in most jurisdictions. Therefore, the contribution of NCP to national economic growth can only increase in future years.

The NCP payments provide an appropriate mechanism to link the states' and territories' agreed NCP commitments with the economic benefits of reform. The legislative reforms are resource-intensive for jurisdictions to implement, especially for smaller states such as Tasmania where the range of relevant legislation is not significantly different from that of the larger states. Furthermore, many reforms are unpopular with particular stakeholders. Without the ability to demonstrate the revenue benefits in the form of the competition payments, the reforms across Australia would not have progressed at the pace that occurred and with the broader community interest which has been generated around the NCP process.

This is most clearly shown by the performance of the Commonwealth, the only jurisdiction not exposed to a reduction in competition payments. The NCC's 2003 assessment was most critical of the performance of the Commonwealth Government, which has a raft of major legislation that restricts competition, such as in the telecommunications sector, where reform is yet to be implemented.

The costs of this lack of progress are borne by the Commonwealth, in terms of the lack of additional taxation receipts. However, the costs are also borne by the states and territories in terms of economic growth and employment in these jurisdictions being lower than otherwise, and also in terms of taxation receipts from the Goods and Services Tax and from State taxes being lower than otherwise.

2.5 Distributional impacts and adjustment costs

The Commission's *Review of National Competition Policy Arrangements - Issues Paper* (Issues Paper) discusses whether distributional impacts and adjustment costs have been adequately taken into account in implementing the reform program.

The Tasmanian Government is committed to implementing reforms only in cases where they bring about a net public benefit. However, the Government is also aware that many reforms that proceed on this basis will impose costs on some in the community. The Government's strong view is that each jurisdiction should determine how these adjustment and distributional impacts are managed.

The NCC should have no role in assessing this policy choice element of the reforms. Similarly, the level of NCP payments should not be affected, as the management of these impacts is unrelated to vertical fiscal imbalance, which is the basis for them.

It would also not be appropriate to impose principles or requirements on jurisdictions regarding the use that is made of NCP payments. The payments were never designed, and are not made, to assist states to compensate interest groups. Furthermore, in many cases, those seeking compensation from the implementation of a NCP reform in one area benefit significantly from NCP reforms in other areas.

Furthermore, NCP payments add to the State's overall revenue base, giving the Government more flexibility to implement measures that improve Tasmania's business competitiveness and, at the same time, benefit those businesses that may be affected by a NCP reform. For example, the 2002-03 State Budget included \$9.4 million in tax relief targeted mainly at small to medium sized businesses, including the abolition of lease and hire duty, the abolition of stamp duty on public liability insurance and a reduction in land tax.

3 Commitment to reform

3.1 Current reforms

Before assessing the impact of NCP, it should be recognised that many major NCP reforms are yet to be implemented. Jurisdictions are still working through their legislation review programs and the benefits, such as of taxi reform, shop trading hours reform and agricultural marketing reforms, are yet to be realised in some jurisdictions. As mentioned previously, the Commonwealth Government, in particular, has a large set of legislation review reforms yet to be implemented.

The pace of energy reform has also varied between jurisdictions. Tasmania, in particular, is yet to experience retail contestability in the electricity industry and the full benefits of gas reform, due to the timetable for the Basslink project and the recent development of the natural gas industry.

Tasmania has completed all of the scheduled State reviews under the legislative review program (LRP), and all review recommendations have been considered by the Government with the exception of some recommendations arising from the review of the *Legal Profession Act 1993* that deal with relatively minor restrictions.

In some important sectors in Tasmania, the benefits of competition will not be available for several years. In energy, for example, significant economic benefits are expected once Tasmania enters the National Electricity Market and the natural gas market matures. To date, the Tasmanian electricity supply industry has undergone significant reform, but this is largely in preparation for entry into the National Energy Market (NEM), which is scheduled to be in May 2005. Retail competition will commence in July 2006 and full retail contestability will be reached in July 2010 provided that extending retail contestability to customers in the last tranche is found to be in the public benefit.

The construction of Tasmania's gas reticulation network has commenced. It is anticipated that by February 2005 up to 23 large commercial and industrial customers will be connected and

by April 2007 gas will be available to 38 500 households. All gas customers will be contestable from the outset.

In the case of the taxi industry, competition will be greater from 2006 onwards, when the process for release of additional taxi licences in urban areas commences (until that year wheelchair accessible taxis will be issued). As part of the State's taxi industry reforms, new taxi licences will be made available in each taxi area, such that there could be potentially an increase of 10 per cent per year in the number of licences. Once again, the full benefits of these reforms, which include greater flexibility in setting fares, cannot be assessed at this stage.

It is not even possible to measure the full benefits of competition once it has been introduced. This is because the dynamic benefits arising from competition, particularly in terms of greater process and product innovation, are longer term benefits and may not be readily apparent.

3.2 Legislative Review Issues

The primary driver for NCP was the desire to improve the competitiveness and flexibility of the Australian economy and deliver higher living standards. Increased competition was expected to promote these aims through the incentives provided to raise productivity, lower costs (and prices), improve quality and to deliver new products and services.

With this underlying principle in mind, the Tasmanian Government believes that NCP should focus on reform areas where there are significant potential economic efficiency benefits, and place less emphasis on reforms that merely redistribute gains between stakeholders within a jurisdiction. This is consistent with the intent of NCP, which is to improve the competitiveness of Australia.

Gaming legislation deals largely with social policy issues. Restrictions on competition, such as the removal of exclusivity arrangements for gaming machines or totalisators would have several social impacts and might redistribute benefits between customers, venue operators, the gaming organisations and the Government. However, there would be virtually no economic efficiency benefits from such a measure and the output of the gaming industry is not an input into other industries. It would therefore be appropriate to exclude gaming legislation from the legislation review obligations under NCP.

Under the *Competition Principles Agreement*, once a party has reviewed legislation that restricts competition the party is required to systematically review the legislation at least once every ten years. This will be costly for the smaller jurisdictions such as Tasmania and may not be a cost effective use of resources if major changes are not anticipated.

Legislation involving such issues as poisons and health services have required an initial review to ensure that the appropriate balance is struck between protection of the public and competition policy. However, once this has been achieved, a full review of legislation, of this nature, every ten years may be unnecessary if there are no major external factors that warrant such a review.

The Tasmanian Government proposes that, instead of the current legislation review process, it would be beneficial to implement a process where the NCC and jurisdictions could, on a

bilateral basis, identify any legislation to be reviewed a second time, based on the extent of the restrictions that remain and the significance of any external factors. This is more likely to ensure that any subsequent review is justified.

3.3 Competitive Neutrality

Competitive neutrality principles aim to remove any unfair advantage that government businesses receive by virtue of their government ownership, unless this can be shown to be in the public benefit. The principles also aim to remove impediments to efficient resource allocation that had arisen due to the favourable regulatory treatment of government businesses.

The competitive neutrality arrangements do not prevent government businesses or significant business activities operating at a loss, providing they apply full cost attribution, (including competitive neutrality costs, which are often relatively minor), and that prices ‘take account of’ these costs. Generally this occurs where businesses provide services that are perceived to have some broader public benefit (such as an aquatic centre or an entertainment centre).

In these cases, the benefit of the competitive neutrality principles is improved information and greater transparency in reporting, rather than ensuring that these businesses price at full cost. This must lead to improved decision making.

In these instances the Tasmanian Government believes that the Commission could consider including a statement of purpose within the *Competition Principles Agreement* that sets out the objectives of the competitive neutrality principles. It would also seem appropriate to consider whether any disclosure requirements should be incorporated into the competitive neutrality principles, in cases where the significant business activities recover revenues that are below full costs.

The Tasmanian Government also believes that clarification is required within the *Competition Principles Agreement* to define where competitive neutrality principles are to apply. For example, it is not clear whether the competitive neutrality principles apply in cases where the government business or activity provides goods or services (possibly in competition with private providers) where the market or consumer is within the same level of government.

An example is where a state’s health agency may licence private ambulance operators for services provided to that state’s public hospitals, and also runs its own ambulances for the same services (for which the hospital services may be provided at low or zero cost). In this situation, the Tasmanian Government suggests that the competitive neutrality principles should not apply as the decision to licence a private operator is a procurement decision.

3.4 NCP compliance by the Commonwealth Government

As stated previously, the Commonwealth Government’s legislative review performance when compared to other jurisdictions was found by the NCC to be well below average and not commensurate with its leadership role in other areas of the NCP. Two of the most significant areas of non-compliance for the Commonwealth were legislation on broadcasting and postal

services and the incomplete review and reform of health-related legislation and legislation on industry assistance.

In the 2003 assessment, the Commonwealth Government was determined to have failed to address the benefits and costs to the community from the restriction on broadcasting, or whether its objectives could be achieved without the restrictions. With regard to postal services, although some reforms have been implemented, the 2003 assessment stated that these do not compare with the enhanced quality of service that would likely arise if Australia Post were subject to competition in the delivery of standard mail and incoming international mail.

Furthermore, as stated in the 2003 assessment, the sector embracing broadcasting and postal services is essential to the efficient operation of the Australian economy and therefore it is necessary that this sector is not encumbered by legislative restrictions on competition that are not in the public interest. It would appear that the failure of the Commonwealth Government to meet its NCP obligations in this sector has resulted in continuing inefficiencies in that sector with flow-on effect to the Australian economy in general.

It is suggested that the Commission consider whether it is possible, within the NCP framework, to provide the Commonwealth with incentives to progress the outstanding reforms.

4 Extension of NCP reform and associated issues

The Commission's Issues Paper discusses the possibility of extending the scope of NCP in other areas of the NCP agenda. The Tasmanian Government considers that, despite the existing reform agenda not having been completed to date, it is appropriate to examine whether NCP can be extended to other areas.

In considering any extension of existing NCP reform, it will be necessary to consider whether the NCC is the appropriate body to assess compliance with a new set of NCP obligations. For example, if an Agreement that has a set of environmental obligations is considered for inclusion, where the issues are highly technical and the benefits are primarily non-economic, the NCC may not be the most appropriate body to monitor and assess compliance.

If new reform measures are to be considered which have financial implications for the states and territories, any additional financial payments should be separate from the current NCP payments.

It is possible that the basis on which the current competition payments are provided (and the penalties levied) would not be applicable for any new financial arrangements. This could arise, for example, if the obligations relate to the environment and are designed to provide non-market benefits, and are not expected to lead to economic growth, and therefore to increased Commonwealth taxation receipts. Some wholly financial arrangements may therefore be needed, rather than including these reform measures within the current NCP framework.

Any future national initiatives or any future agreements that are brought into the NCP framework must reflect the different circumstances of each state and territory. Some major

environment policy problems arise due to cross border issues of mainland states and territories. In these cases, the relevant jurisdictions should be listed (as they were in 1995 in relation to electricity and gas reform), without the inclusion of Tasmania. For example, jurisdictional differences in water management issues should be taken into account. Tasmania's rivers are not over-allocated compared to those in the Murray Darling Basin, and Tasmania does not have to deal with cross-jurisdictional water management concerns. Furthermore, the water trading market in Tasmania is not yet highly developed and to this extent the NCP needs to consider the developmental nature of the water market in different jurisdictions and take these differences into consideration when seeking public benefit tests.

Similarly, any new obligations should take into account the potential benefits, and therefore the cost effectiveness, of the measures proposed for the relevant jurisdictions. It would not be appropriate, for example, to include in a new water management agreement high cost monitoring and research obligations which may be justified for major river systems in mainland Australia, but not for much smaller, less stressed river systems in Tasmania.

5 Competition related reforms outside the current NCP areas

The Commission's Issues Paper proposes considering extending NCP by examining the feasibility of the application of market-based mechanisms to health, education and employment services, including competitive tendering and contracting out arrangements. The Tasmanian Government considers that this is a major departure from the current set of NCP obligations and is not persuaded, at this stage, that this is likely to be acceptable to jurisdictions. The Tasmanian Government considers that the most efficient and appropriate method of delivery of core government activities, such as education and health services, should be determined by each relevant government.

The Tasmanian Government would also have concerns if a 'one size fits all' approach were adopted and a formal set of obligations were set out. A preferred approach is to allow each jurisdiction to determine the extent to which market-based mechanisms should be applied. This would allow the Commonwealth and the states and territories to retain the flexibility to examine these issues and consider options based on the circumstances in each jurisdiction.

The submission also raises the possible extension of NCP's scope to reduce the costs and misallocation of resources that arise from "bidding wars" between jurisdictions to attract investment and employment. The Tasmanian Government considers that there is some merit in this suggestion.

While this matter has not been of great importance nationally during the past decade due to the generally robust Australian economy, there is a potential for this to become an important issue for smaller economies, such as Tasmania, in the event that national economic growth slows and investment becomes more difficult to attract. As such, the Tasmanian Government would support, in principle, considering the feasibility of including this type of restriction on competition within its scope.

Again, the Tasmanian Government considers that any new NCP Agreement should be in addition to the three current NCP arrangements, with a separate set of financial arrangements, if appropriate.

6 Conclusion

The Tasmanian Government acknowledges that NCP has achieved much in the eight years since it was introduced. In view of the COAG review of NCP arrangements it is timely for the Commission to assess the initial and ongoing impacts of NCP and related reforms undertaken to date and investigate areas offering further opportunities for significant gains to the economy from removing impediments to efficiency and enhancing competition.

As part of the inquiry the Tasmanian Government has taken the opportunity to provide this submission to the Commission and present a number of key statements:

- current NCP arrangements are working well and are delivering substantial economic benefits;
- NCP has brought about major changes in the way the Tasmanian Government regulates markets and the way publicly owned businesses behave;
- it will always be difficult to measure all the economic benefits of NCP;
- the current level of NCP payments is appropriate given the level of contribution of NCP to national economic growth and the additional future contributions as the reforms are implemented;
- competition payments should continue to be part of the Commonwealth Government's General Purpose Payments (GPPs) to the State and not tied to any specific purpose or to be directed to any specific interest groups;
- instead of the current legislation review process, it would be beneficial to implement a process where the NCC and jurisdictions could, on a bilateral basis, identify any legislation to be reviewed a second time, based on the extent of the restrictions that remain and the significance of any external factors;
- before considering new reform activities, the Commission and COAG should recognise that many of the important reforms agreed to in the three NCP Agreements are yet to be implemented;
- in any possible extension of existing NCP reform, it is very important that the most appropriate body assess compliance;
- if new reform measures are to be considered, any financial payments should be separate from the current NCP payments;
- any future national initiatives or any future agreements that are brought into NCP must reflect the different circumstances of each state or territory; and
- NCP should place more focus on reform areas where there are significant potential economic efficiency benefits, and place less emphasis on reforms that address social policy issues or merely redistribute gains between stakeholders within a jurisdiction.

