

**Submission from the Public Interest Advocacy Centre  
to the Review of National Competition Policy Arrangements  
June 2004**

## **The Public Interest Advocacy Centre**

The Public Interest Advocacy Centre (PIAC) is an independent and non-profit legal and policy centre located in Sydney. Its charter is:

To undertake strategic legal and policy interventions in public interest matters in order to foster a fair, just and democratic society and empower citizens, consumers and communities.

Established in July 1982 as an initiative of the Law Foundation of New South Wales, PIAC was the first, and remains the only, broadly based public interest legal centre in Australia. Although located in New South Wales, the matters PIAC undertakes are often of national interest or importance or have consequences beyond state boundaries.

PIAC's work extends beyond the interests and rights of individuals as it specialises in undertaking matters which have systemic impact. The Centre's clients and constituencies are primarily those with least access to economic, social and legal resources and opportunities. PIAC provides its services for free or at minimal cost.

The Utility Consumers' Advocacy Program (UCAP) was established by PIAC in 1998 with funding from the NSW Government. Its mandate is to represent the interests of residential users of energy and water (especially those on low-incomes or facing disadvantage) to industry, regulators and government.

---

## Introduction

The main stated aim of National Competition Policy was to increase competition and economic efficiency in the economy through the application of national uniform competition laws and policies across all industries and areas. NCP was specifically aimed at applying market principles to publicly owned utilities supplying essential services like energy, water and public transport and to public services more generally. It was argued that prices of such services should reflect costs, and that this would lower prices for business, contributing to economic efficiency. However it was conceded that costs to individual consumers might rise through the removal of cross-subsidies, a process delicately called price "rebalancing."

Economic theory tells us that competition produces efficient outcomes only under certain market conditions. These include substitutable goods, a large number of buyers and sellers, perfect knowledge by all parties, elastic demand, (meaning that demand will respond to price signals), no natural monopolies and no externalities like environmental pollution. If these conditions are not present, competition will not maximise efficiency in the way predicted by the theory, resulting in market failure. Economic theory also tells us that many essential services like water, electricity, public transport or health are not normal goods because they are not substitutable, and have inelastic demand because consumers cannot choose **not** to consume them without both risks to individuals and considerable social costs. These goods often require government intervention in markets to ensure equitable access to them.

NCP also applied competition principles to professional services and statutory marketing bodies, and initiated reviews of government regulation to evaluate whether regulation restricted competition. PIAC will not attempt to comment on these areas, but will confine its comments to the impact of competition policy to the application of the public interest test, the impact of NCP on consumers of energy and water services and the proposals to extend competition policy into other areas of community services.

### **Inconsistent Application of the Public Interest Test**

The Issues paper for this Inquiry claims that NCP recognises that 'competition is not an end in itself and that it is not necessarily desirable or practical to promote competition in every activity,' and that NCP "reform" should be "in the public interest" (Productivity Commission 2004, 1).

This reflects the NCP "public interest test," intended to ensure that the promotion of competition was not inconsistent with social, environmental, health, equity and regional objectives. This test was not in the original NCP proposals, but was added to the Competition Policy Agreement after lobbying from community organisations concerned about the abstract and wholesale application of competition principles to many areas of public policy (Ranald, 1995, 4 ).

However, the test was voluntary, with a preamble which stated that governments "may " take these issues into account "where relevant." (Competition Principles Agreement, 1995, 10)

The public interest test was criticised by the Business Council of Australia on the grounds that it detracted from the goal of economic efficiency (Daniels, 1996, 20). The National Competition Council made it clear that governments were not obliged to conduct formal public interest tests (National Competition Council, 1996, 10).

As a consequence there has been no consistent application of the public interest test by various governments. This was confirmed by a Senate Inquiry Report in 2000 which found that there had been "inconsistent application and interpretation of the public interest test with its domination by economic assessment ahead of the harder-to measure intangible attributes in the social and environmental areas" (Senate Select Committee, 2000, xiii). This inquiry and the 1999 Productivity Commission **Report on the Impacts of Competition Policy on Rural and Regional Australia** recommended more consistent application of the public interest test ( Productivity Commission, 1999, xxx) but these recommendations have not had any noticeable effect.

---

## **Cost and benefits, winners and losers from NCP**

As the Commission recognises, competition reform has produced ‘winners’ and ‘losers’. In its *Issues Paper*, the Commission argues that the fact of some groups or individuals having been net ‘losers’ is not sufficient grounds for forgoing reforms which have a net benefit to the wider community.

The weakness in this approach is that in some circumstances it creates a conflict between those who may expect to benefit from competition reform against the majority in the community for whom this process has created only extra costs. The competition reforms so far undertaken in the electricity and gas industries illustrate this problem.

Full retail competition (FRC) is the process by which retail energy competition (choice of retail providers) has been introduced to residential consumers in several jurisdictions. In the case of larger users (for electricity these consume greater than 160Mwh per year) the nature of the commodity and the structure of the industry has meant that reform could deliver cost savings.

Similarly, a minority of household users, those with particular levels and patterns of consumption, may pay lower prices as a result of retail competition. However, it is clear that, for the wider community, these benefits are outweighed by the costs associated with the introduction of FRC that are passed on to consumers. These costs include the infrastructure for retail competition (such as the construction of a national customer database) as well as the business costs incurred by the retailers themselves such as marketing and compliance with the FRC regulatory arrangements.

The difficulty in the case of electricity and gas is that it is impossible before the fact to identify which households or individuals will take up the opportunity to enter the competitive market and exercise their choice of energy retailer. More to the point, were the costs of competition reform restricted only to the direct participants in FRC these would eclipse all the price benefits and result in FRC being stillborn.

However, it is clear that the providers active in the ‘competitive’ segment of the energy retail market wish to have only a small minority of residential users as their customers. As a result, the introduction of FRC has been undertaken on the basis that almost all the costs will be allocated to households on a universal basis despite the knowledge that only a minority will ever be in a position to realise the benefits of reform.

It is no surprise to PIAC or to other community groups to see that the vast bulk of households are excluded from the competitive arrangements by the behaviour of retailers. It is precisely this kind of market failure that saw the development of the former publicly-owned energy industries throughout Australia. Indeed, we had warned prior to the commencement of FRC that the structure of the electricity industry, in particular, would produce this very result (PIAC, 2000 : 2). Our own anecdotal knowledge of the restricted marketing practices of competitive energy retailers has been backed up by the industry regulator in Victoria (ESC, 2003 : 59).

While being excluded from the benefits of reform the majority of households have subsidised the gains for the few by bearing many of the costs of FRC. This includes a reported cost to the NEM jurisdictions of over \$100 million for the national customer database (NEMSAT). In NSW the natural monopoly electricity distributors were granted \$70 million in the 2000/2001 State Budget to meet their costs arising from FRC. Still in NSW, ‘standard’ electricity customers (those buying power from the incumbent retailers) have been required by the economic regulator to pay a small annual premium to defray the costs incurred by their retailers in marketing competition-based supply contracts to that small minority of ‘eligible’ households.

The Commission argues that the existence of a small number of ‘losers’ should not deny the benefits of competition to the majority. In our view it is clear that competition reform in electricity and gas has resulted in a wide distribution of costs yet succeeded in delivering benefits (and modest gains at that) to a tiny proportion of the community (measured by those who have been able to change their retail supplier). We cannot see that this has served the public interest.

Nor does PIAC accept that this outcome is a result of the way in which competition reform has been undertaken in these industries. Rather, this reflects a failure to consider properly whether competition reform was appropriate given the nature of energy as a commodity and the resultant structure of these industries. PIAC and others had warned prior to the introduction of FRC that this result was to be expected.

### **Impact of reforms**

The Commission has asked for specific examples of the impact of competition reforms. One of the challenges for the Commission and other competition reform advocates is to demonstrate that economic gains and increased consumer benefit have come about directly as a result of the reform process. The widely varying estimates of the gains from competition reform call into question whether this can be done. Certainly they have the effect of reducing the willingness of the community to bear the associated costs of reform.

In the case of household energy, however, it is instructive to look first at the outcomes achieved prior to FRC. In a report on infrastructure prices the Commission presented evidence of a 'significant' reduction in household electricity prices over the 1990-91 to 2000-01 period (Productivity Commission, 2002b : 11). It was reported that across Australia, households had saved a total of \$70 million in the 2000-01 year alone. These savings are very modest by comparison with total household expenditure on electricity in 2000-01 of \$3.5 billion (Productivity Commission, 2002b : 18).

These benefits were accrued by residential users well before the introduction of full retail competition. The Commission claims that these savings were delivered through corporatisation and other 'competition based' reforms of publicly-owned electricity businesses. In fact, much of these savings were the result not of competition but regulation and improved efficiency and performance by the largely publicly-owned electricity industry. It is apparent to consumers that whereas direct regulation and State intervention in these businesses produced measurable price falls the move to a more competitive model has been accompanied by continual upward pressure on the prices of this essential service.

We note that the benefits for household electricity users are far less than those enjoyed by larger consumers in the business sector. For example, the Commission reported that in NSW alone in the year 1999-2001 business customers of the State's electricity retailers were saved \$1 billion dollars through a combination of reforms. It is important, too, to bear in mind that the far more modest gains enjoyed by residential users were spread across all jurisdictions and that some households did, in fact, experience 'real' price rises during that decade.

The necessity to defray the costs of establishing FRC by passing these through to consumer prices has undermined the gains achieved by the earlier reforms to the electricity industry.

These FRC related costs have come in addition to the other price increases which resulted from reforms such as the introduction of 'efficient' or cost reflective pricing. Electricity distribution is a natural monopoly. Nonetheless, the same 'competition related' reforms have been introduced to this industry during the last decade. As a result many consumers, and especially rural households, have had to bear increases in the cost of electricity.

It is argued that these price increases merely reflect the requirements of 'efficient' pricing and have effected the removal of hidden cross-subsidies. On the other hand, the reforms have left other cross-subsidies in place - notably those which smear the costs of retail competition onto the majority 'monopoly' customers.

Furthermore, this price restructuring has produced many 'losers' but few 'winners'. The public interest test for competition reform is supposed to ensure that the net gains outweigh the costs. Yet, in the case of reforms to electricity pricing, while rural households have seen their cost of electricity rise there have been very few residential customers who have received a price benefit - and those all are concentrated in a few urban areas. In other words, pricing reform in electricity has failed the public interest test.

Competition in the generation sector of the electricity industry also has brought higher costs for consumers. We note that considerable new investment has been attracted to electricity generation following competition reform. However, almost all the new plant which has been built or announced in recent years has planned on the basis of higher prices for wholesale electricity. The current preference for gas-fired peak-load generation reflects the higher



returns which can be achieved in a competitive market marked by significant price volatility (rather than competition per se). Unfortunately, consumers must bear the higher average costs of energy which result from the changing mix of generation sources while at the same time paying the cost of hedging contracts and risk premiums being taken up by retailers.

The Commission has asked whether an assessment of the benefits and costs was undertaken prior to the reforms being implemented. This was done by PIAC and other community groups who argued consistently to agencies such as NSW Treasury that the balance of the reforms in energy would be a net disbenefit for the great majority of households. Despite our best efforts the Treasury maintained until the last few months before FRC that retail competition and choice of supplier would bring widespread price benefits (NSW Treasury, 2001 : 19, 12). It was almost belatedly that the NSW Government began to focus on the primary gains of FRC being ‘innovation’ in the retail products offered by energy retailers.

The lack of interest from residential consumers for retail energy competition can be explained in part by the higher costs which the reforms have brought. Yet, it is difficult to see how many households would ever have been attracted by the promise of innovation for what remains an essential service.

PIAC is not aware that a more searching assessment of FRC and the precedent competition related reforms was undertaken by the NSW Government or its agencies. This would have been appropriate prior to retail competition being extended to ‘small’ customers - those using less than 160Mwh per year. If any such assessment was undertaken we are not aware of the results ever having been made available to the public.

### **Unfinished business**

The Commission has noted the view that there remains ‘unfinished business’ in relation to competition reform of the energy and water industries. The question has been posed in the *Issues Paper* as to whether the current NCP framework is the most effective way of progressing and extending competition reform.

In response, PIAC would point out that both these industries are highly capital intensive, characterised by expensive and long-lived assets. Thus the apparent level of competitiveness in these industries may not be the major factor in investment decisions. Nor is it always the uppermost concern of regulators or governments. The behaviour of private capital with respect to investment in generation illustrates this point. Indeed, even in the less capital intensive function of energy retail it is clear that investment decisions and commercial behaviour are not based primarily on the theory of competitive markets and consumer choice.

The most intense competitive behaviour is not the pursuit of market share but that which takes place in front of the regulatory authorities. The energy businesses and private investors have learned quickly that the structure of the energy industries provides very little room for competition around price or performance. This largely reflects the success of the regulation of the corporatised or privatised entities. As a result, the businesses have learned quickly that they can better maximise their return on investment by securing more favourable decisions from the respective regulators.

This has meant that the key decisions are focussed on such areas as the valuation of regulated asset bases; the maximum allowable rate of return; the regulatory allowance for the weighted average cost of capital; and approvals of capital spending forecasts.

These debates take place not only in front of the regulator but increasingly in the courts. All these questions have a major impact on the prices which consumers pay for essential energy and water services. In other words, many of the same businesses who ignore the majority of residential consumers and the market share they represent are more than ready to pursue a form of competition which has a direct impact on consumers but in which they have no market power whatsoever.

This 'regulatory competition' excludes consumers on the one hand because individually and collectively they lack the resources to compete with the utility companies. Indeed, it can be observed that the regulators, too, often suffer from this problem. On the other hand, even if consumers could exert a positive influence on regulatory decision-making the companies increasingly are willing to challenge those decisions in the courts. Currently, residential

consumers are excluded from these proceedings not only for a lack of resources but by an apparent lack of the legal standing needed to participate.

In our view, the task for the advocates of further competition measures in the electricity and water industries is to demonstrate that an extension of competition will result in better outcomes for consumers.

A current example of the demands for an extension of competition in electricity is the function of metering services. This encompasses the supply of meters to residential premises (currently a monopoly activity undertaken by electricity distributors) as well as the ‘reading’ of meters to collect data on customer consumption (often contracted to third parties).

The NSW Government has put the view that competition in metering services will promote ‘innovation’ (Ministry of Energy and Utilities, 2003 : 6). It seems this is becoming a standard claim for the benefits of competition.

PIAC has pointed out that for residential customers the cost of metering services is a very small proportion of final bills. Establishing a competitive market in this area would require additional layers of regulation and further costs for households such as the recovery of sunk investment. These costs would far outweigh any benefits of competition in metering services. Nonetheless, many policy makers and metering providers continue to argue the view that because metering services can be made competitive in practice this is sufficient reason to force these activities into a competitive arrangement.

A second example is the demand from some sections of the retail energy industry for regulators to stimulate greater competition by building ‘retail headroom’ into regulated tariffs. These tariffs protect vulnerable households from price exploitation by their incumbent suppliers. The need for these protections has only been strengthened by the decision of ‘second tier’ retailers to exclude the vast bulk of residential consumers from the competitive retail market.

Particularly in NSW, the economic regulator has made substantial efforts to ensure that the regulated electricity tariff reflects efficient costs of supply and a modest premium for

commercial margins on the part of the retailers. It also includes a small margin related to future wholesale costs of electricity.

Yet, once more in defiance of the public interest test and the objectives of competition policy, almost all the publicly-owned and private retailers have at various times called for the regulated tariff in NSW to be raised artificially in order that second-tier retailers will have a greater opportunity to compete with the incumbent businesses. That is, it is argued that residential customers of the incumbent retailers should pay more than the efficient, sustainable cost of electricity supply for no other reason than this would provide an opportunity for new entrants to 'compete' by offering prices closer to what is the current 'efficient' price.

We note, furthermore, that the advocates of retail headroom have not suggested that the second tier retailers would have an obligation to provide choice to all residential users by ending their practice of refusing supply contracts to those households deemed to be not commercially attractive.

Demands for retail headroom reflect poorly on competition policy. They also illustrate the dangers to consumers of extending competition reform in these and other industries.

**Recommendation: That given the absence of evidence of benefits for the majority of consumers there be no extension of competition measures in the electricity and water industries.**

### **Application of competition and marketisation to community services**

As the discussion paper notes, NCP did not require privatisation or competitive tendering of utilities or government services. However some governments, eg the Kennett Victorian government, used it as a justification for these policies (Victorian Government, 1996, 9), and this did not seem to be contested by the national competition bodies. The discussion paper notes that such policies "share the same underlying rationale" and they have in fact been promoted by the Productivity Commission and other supporters of NCP (Productivity Commission, 2004, 2).

It is therefore somewhat disingenuous for the Commission to claim that negative effects of privatisation or contracting out on service provision or regional employment should not be attributed to competition policy. This applies especially when it is recommending the extension of competitive tendering and other "competition related" measures into areas of community services such as aged care, disability services and child care (Productivity Commission, 2004, 11).

Despite claims about consumer choice and improved services, the main rationale for competitive tendering has always been cost savings, achieved through lowest price tendering, regardless of the effect on services. The Commission's discussion paper in fact gives cost savings as its main rationale for proposed extension of competition into the community services area (Productivity Commission, 2004, 11). Generally competitive tendering does not provide consumer choice as the service is simply provided by a private rather than a public provider.

The Commission's 2002 Review of the Job Network pointed to many of the pitfalls of applying a competitive tendering model to human services, using financial incentives for providers. The report noted that the "market" for employment services does not meet the conditions for the efficient operation of a market outlined above and has to be highly managed by government (Productivity Commission, 2002a, xxxi).

The report conceded that consumer choice is not provided in reality because of lack of knowledge about providers available to job seekers (Productivity Commission, 2002a, xx). Lack of funds for travel also result in many job seekers using the nearest provider .

The Report conceded that competitive tendering based on lowest price tenders can undermine the quality of employment services as providers cut essential inputs in order to win contracts. This applies especially to firms operating on a commercial for profit basis which must give priority to profit maximisation. Economic incentives can result in the "parking" of difficult clients while priority is given to those who can quickly attract the most income for the service provider (Productivity Commission, 2002a, xxvi). The report also noted a number of well-documented cases of fraud by service providers through the "manufacturing" of jobs or the

recycling of job seekers through the same job in order for the provider to receive outcome payments (Productivity Commission, 2002a, xxx). These issues point to conflicts of interest between the objectives of delivering high quality services and profit maximisation for private commercial firms which are examined further below.

The report placed less emphasis on the impact on job seekers of market failure when providers experience commercial failure between contracts. The service simply disappears and they are transferred to another service provider. However the report does concede that competitive tendering is complex and expensive for providers and disruptive to services and job seekers when service providers change with the tendering cycle (Productivity Commission, 2002a, xix).

The Report recommended even greater "management" of the market in the form of licensing rather than competitive tendering and administered prices rather than price competition (Productivity Commission, 2002a, xx). Given these recommendations it seems inconsistent to say the least for the Commission to be proposing extension of competitive measures, including competitive tendering and contracting out, to other community services. The Commission seems indeed to be recommending "competition for competition's sake", despite its claims to the contrary.

Another pitfall of private provision of services is the reduction in government accountability for services and the lack of redress for individuals against the decisions of private contractors. Such contractors are not generally subject to Freedom of Information or Administrative Appeals processes, despite the fact that they may be administering government programs and making decisions that profoundly affect people's lives. The removal of these areas of decision making from public accountability is a substantial reduction in democratic rights and accountability for those affected by these programs. It also diminishes government public accountability, as governments have attempted to disclaim but have ultimately had to accept responsibility for service failures by contractors, ranging from prison services to water services (Ranald, 1997, 14, and Ranald and Black, 2000, 28). The issue of accountability was also noted in the Commission's report on employment services, in assessing whether a competitive model with private contractors could be applied in the social security system (Productivity Commission, 2002a, 15.17).

Public opinion polls show that there is strong public awareness of these issues, based on the experience of privatisation and contracting of services. Public opposition to the application of market principles to community services, especially the provision of such services by commercial for-profit firms, has grown as Australians have experienced the impacts of competitive tendering and privatisation over the past decade. Previous opinion polls and more recent research by Dr Gabrielle Meagher shows that there is overwhelming public support for the delivery of health and aged care by government agencies or non profit community-based bodies, rather than private firms, based on a perceived conflict of interest between profit maximisation and service delivery (Meagher, 2004, quoted in Wade, 2004).

**Recommendation: That there be no further extension of competition principles like competitive tendering to community services.**

#### **Competition and the Labour Market**

The discussion paper briefly mentions restrictions on competition in the labour market and the possible extension of NCP initiatives into this area.

Australia has ratified the United Nations conventions on Human Rights and International Labour Organisations on the rights of workers, which support freedom of association in the workplace and the right of workers to bargain collectively with the employer to achieve humane minimum working conditions for all (United Nations, 1948). These and related conventions ratified by Australia and other countries are based on the recognition that human labour is **not** a commodity to be treated in the same way as other commodities in the market place. There is an inequality of power between workers and employers. Collective bargaining helps to redress this power imbalance and to achieve legal minimum standards. The Australian industrial award system is based on these principles, but they have been undermined by recent legislative amendments that have reduced the right to collective bargaining and enabled employers to impose individual contracts by making them a condition of employment or refusing to negotiate collective agreements. Only a minority of employers and workers have used individual contracts, and the vast majority remain within the award system.

**Recommendation: Competition principles should not be extended to the labour market, as human labour is not a commodity. The application of competition principles to the labour market would erode human rights and minimum labour standards.**



---

## References

"Competition Principles Agreement" (1995) reprinted in National Competition Council (1997) **Compendium of National Competition Policy Agreements**, AGPS, Canberra.

Daniels, T., (1996) "National Competition Policy: the way forward, **Business Council Bulletin**, August/September, pp. 16-22.

Essential Services Commission, Victoria (2002), **Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity – Final Report**, Essential Services Commission , Victoria, September 2002

Ministry of Energy and Utilities (2003), **Metering Services Competition : Consultation Paper**, April 2003

National Competition Council, (1996) **Considering the Public Interest under National Competition Policy**, AGPS/Panther Publishing, Canberra.

NSW Treasury (2001), **Regulatory Impact Statement : Electricity Supply (General) Regulation 2001**, September 2001

PIAC (2000), **Competition and costs : Electricity prices for residential users**, UCAP Occasional Policy Paper No. 2, July 2000

Productivity Commission, (1999) **Report on the Impacts of Competition Policy on Rural and Regional Australia**, Report No. 8, September.

Productivity Commission (2002a) **Independent Review of the Job Network**, Report no. 21, Canberra.

Productivity Commission (2002b), **Trends in Australian Infrastructure Prices 1990-91 to 200-01**, May 2002

Ranald, P, (1995) "Competition Policy" in **Journal of Australian Political Economy** no. 36, December

Ranald, P, (1997) **The Contracting Commonwealth: Public Accountability, Service Quality and Equity Issues in the Contracting and Competitive Tendering of Government Services**, Public Sector Research Centre, UNSW.

Ranald, P, and Black, B, (200) "Privatising Water in the Driest State" in **Labour and Industry**, Vol 11, no.2, December 2000.

United Nations, (1948) **Universal Declaration of Human Rights**, Geneva.

Victorian Government (1996), **Policy Statement on Competitive Neutrality**, Melbourne.

Wade, M., "Care Industry can't discount the love factor," **Sydney Morning Herald**, April 17-18, 2004, p. 46.