Product Market Reform

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One of the most important reasons for Australia's relatively poor productivity performance in the 1970s and 1980s discussed in Chapter 2 was the historical lack of openness of the economy, owing to high import barriers and the extensive domestic regulation of product markets. As this problem became clear in the mid-1980s, the authorities responded by embarking on a comprehensive set of reforms to open up the economy to international trade and increase competition across a wide range of markets. Most important, tariffs were reduced, while key sectors—such as financial services, telecommunication, and aviation—were liberalized, and public enterprises corporatized or privatized. More recently, competition policy principles were extended to previously sheltered sectors, including the state-owned enterprises.

This chapter discusses the role of tariff barriers and product market regulation in hindering productivity growth, and then outlines the reforms in these areas. An assessment of the microeconomic impact of these reforms is presented here, while an assessment of the macroeconomic impact of these reforms is presented in the next chapter.

The Impact of Tariff Barriers on Productivity

Traditionally, Australia has been a less open economy than many other OECD countries, as measured by exports and imports as a share of GDP. In part, this can be explained by its geographical isolation from its main trading partners. This does not explain, however, why Australia's degree of openness remained at roughly the same level from the
Table 7.1. **Average Tariffs on Imports**

*In percent*

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<th>1965</th>
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<td>Australia</td>
<td>9.6</td>
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<td>Belgium</td>
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<td>Denmark</td>
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<td>Finland</td>
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<td>France</td>
<td>6.1</td>
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<td>Germany</td>
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<td>Italy</td>
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<td>Japan</td>
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<td>Netherlands</td>
<td>5.7</td>
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<tr>
<td>Norway</td>
<td>4.0</td>
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<td>Sweden</td>
<td>6.3</td>
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<td>United Kingdom</td>
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<tr>
<td>United States</td>
<td>6.7</td>
<td>4.4</td>
<td>3.5</td>
<td>2.6</td>
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<tr>
<td>Average (excluding Australia)</td>
<td>5.9</td>
<td>2.0</td>
<td>1.7</td>
<td>2.1</td>
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</table>

Source: EPAC (1996) based on OECD data on revenues from customs and import duties relative to the value of imports. For 1995, updated from IMF, Government Finance Statistics and World Economic Outlook Databases, where consistent data were available.

1960s through the 1980s, while openness of the Group of Seven and smaller industrial countries increased by more than 50 percent. The root cause of Australia's limited international integration was not its geographical isolation, but its high tariff barriers.

High tariff barriers were a traditional feature of economic policies in Australia. In the mid-1960s, the average tariff on imports was 9½ percent, compared with 6 percent on average in the main OECD countries (Table 7.1). Subsequently, Australia's average import tariffs rose to more than 12 percent in the mid-1970s, and declined after that only slightly to less than 10 percent by 1985.1 This was in stark contrast to the steady decline in average tariffs in the main OECD countries (to about 1¾ percent in 1985).2

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1Although trade barriers were reduced in the early 1970s for a range of goods, this was largely offset in aggregate by an increase in protection for the passenger motor vehicle and textile, clothing, and footwear industries.

2In many OECD countries the extent of assistance to industry in other forms (e.g., direct subsidies and nontariff measures) was more significant than in Australia. In Australia, subsidies to industry amounted to 1.7 percent of GDP in 1985 compared to an average of almost twice that level for OECD countries (IMF, 1992, p. 123). Nontariff measures increased in the United States and Europe in the first half of the 1980s as tariff barriers fell (IMF, 1992, p. 13), but remained largely unchanged in Australia ahead of the reforms in 1988. Furthermore, antidumping measures in force in Australia fell significantly in the mid-1980s, but increased sharply in the United States.
High tariffs damaged Australia's economic performance in a number of ways. They reduced output by diverting production away from areas of comparative advantage, and reduced consumer well-being by raising the prices of imported and import-competing goods. They also reduced the dynamism of the economy. A number of country studies have shown that lower openness to international trade impedes the international diffusion of knowledge and transfer of technology, and stifles innovation and growth by reducing the effective market size for producers, and increases rent-seeking activities (see IMF, 1994, p. 27). Perhaps most important, high tariffs discourage firms from adjusting to changing circumstances by shielding the economy from the pressure to adapt to world best practices and most efficient means of production.

In fact, a recent study by the Economic Planning Advisory Council (EPAC, 1996) found that Australia's failure to match the tariff cuts in other OECD countries was the predominant cause of its relatively poor productivity performance over the period 1970–1989. More specifically, the study found that differences in tariff rates were one of the most robust and highly significant reasons for differences in productivity growth across 14 OECD countries from 1970 through 1989. This holds true even after other factors, such as convergence and structural change, are taken into account.

A particularly interesting case is that of Finland, whose tariff policy during 1965–85 was diametrically opposite to that of Australia. While both countries started in 1965 with similar average import tariffs (around 10 percent, among the highest for OECD countries in 1965), by 1985, Finland had cut its average tariff rate to 1 percent, whereas tariffs in Australia had increased. Partly as a result, Finland experienced per capita growth during 1965–85 significantly above the OECD average; the EPAC study attributes about 60 percent of this growth to the dismantling of tariff barriers.

3The study decomposes the deviations of the various country growth rates from the OECD average and finds that about 80 percent of Australia's below-average growth through the 1970s and 1980s was due to the tariff regime; the remainder was due to lower capital productivity and convergence effects (given that Australia's income level was above the OECD average then). The study attributes this large impact to the fact that changes in tariffs have proxied for a much wider range of policy changes, including a host of domestic reforms that are generally triggered by tariff cuts. These include reforms to the goods and labor markets and the financial sector. The efficiency gains from such reforms, induced by tariff cuts, are estimated to be up to 10 times higher than the static efficiency gain from the tariff cut itself.
The Impact of Product Market Regulation on Productivity

Australia has for long periods limited competition across a wide range of sectors. Even in 1993, the level of market dominance in Australia was the sixth highest in the OECD, with four firms accounting for almost half the turnover in one-third of the industries (based on a two-digit industrial sector classification). One reason is that state-owned enterprises dominated many markets—including through monopoly rights—especially in utilities and transportation (including rail, ports, and airports). Because Australia is a large country, remote from major markets, efficient infrastructure provision is especially important. Yet, in many cases, prices for these basic services have been considerably higher than in other countries, thereby raising the input costs faced by other sectors, and damaging their competitiveness.

Tight regulation has also affected productivity across a wide range of other sectors. A recent study of business sector productivity in Australia (McKinsey, 1995) found that excessive regulation of financial and product markets was a significant reason for low productivity in many sectors. As a result, in 1993, Australia was seen as lagging behind world best practice in the retail sector by 20 percent, the aviation sector by 16 percent, and the banking sector by 40 percent. The study also highlighted several other related factors that contributed to low productivity, including limited competition and a high level of market dominance. These led to a slower adaptation of innovative processes, products, and services, and lower management aspirations to adopt successful management methods from overseas.

A further study by the Productivity Commission (1996) showed significant performance gaps between Australia and world best practice in the provision of infrastructure. For instance, the telecommunications industry in Australia was found to be lagging behind world best practice (on price performance) by almost 60 percent, electricity by almost 80 percent, gas supply by more than 60 percent, and rail freight by almost 70 percent.

What Has the Government Done?

Since the mid-1980s, the government has attempted to address this situation by implementing a unilateral tariff reform program, introducing a national competition policy, and deregulating parts of the economy, particularly the financial sector and public enterprises.

Tariff Reform

Australia has made considerable progress in reducing trade barriers since the late 1980s. The authorities have backed up their strong com-
mitment to multilateral trade liberalization by leading the way with a series of phased, unilateral tariff reductions. The first program, implemented between 1988 and 1992, reduced almost all tariffs to a maximum of 15 percent. Another program, announced in 1991, reduced maximum tariffs to 5 percent by 1996. An exception was made in these programs for the passenger motor vehicle and textile, clothing, and footwear sectors, which were subject to separate industry plans because of their poor competitive position. Reviews of these sectors by the Industry Commission in 1997 recommended an accelerated program of tariff reduction to bring them in line with the general tariff level. The government decided not to implement these recommendations, however, instead opting to freeze tariff rates in these sectors between 2000 and 2005, although further reductions will be made after 2005 to meet Asia and Pacific Economic Cooperation (APEC) commitments to free and open trade by 2010.4

As a result of the tariff reform, the average tariff on imports declined from 10 percent in 1985 to about 3½ percent in 1997. Moreover, the Industry Commission (1996, p. 118) estimates that by 2000 the average tariff will be less than 3 percent. Even then, however, Australia's average tariff would remain somewhat above the OECD average.

Progress in reducing nontariff trade barriers is more difficult to assess, since these barriers are difficult to identify and quantify. The OECD found a significant decline in nontariff trade barriers in recent years, however, as a result of the abolition of all quantitative restrictions on imports (OECD, 1996, p. 17).

Owing to the trade reforms, rates of effective assistance to certain sectors have declined significantly (Figure 7.1). In particular, for the manufacturing sector, the rate of effective assistance fell from 22 percent in 1985/86 to 6 percent in 1996/97 and is scheduled to decline to 5 percent in 2000/01 (Industry Commission, 1997).

4 Nonetheless, import quotas on passenger motor vehicles were lifted in 1988 and tariffs have fallen sharply (from 58 percent in 1988 to 25 percent in 1996) and will fall further to 15 percent by 2000 and 10 percent in 2005. For the textile, clothing, and footwear industries, tariffs were reduced from 55 percent in 1990 to 37 percent in 1996 (and import quotas were lifted in 1992). By 2000, tariffs in these sectors are scheduled to be phased down across the board to about 25 percent for clothing and other finished textiles, 15 percent for footwear and fabrics, and 5 percent for other products. From 2000, tariffs on textiles, clothing, and footwear will be frozen until 2005, when they will be reduced to a maximum of 17½ percent. At that stage, a review will be held to consider further cuts to meet Australia's APEC commitment to free and open trade by 2010. Also, tariffs on dairy products and vegetables remain above the general tariff level and a schedule to phase them down exists only for vegetables (to 5 percent by 1998).
Australia has also been closely involved in regional trade liberalization forums, particularly the APEC initiative and Closer Economic Relations Agreement with New Zealand (see Box 7.1).

Deregulation of the Financial Sector

Australia has been deregulating the financial sector since the early 1980s. The reforms have brought significant net benefits on balance, with the benefits of greater choice, innovation, and flexibility of services and increased cost efficiency outweighing transitional problems of excessive credit expansion in the late 1980s.

Background

Australia’s banking system had been tightly regulated. By the end of the 1970s, it was clear that banking regulation was creating serious distortions and inefficiencies. In particular, regulation had contributed to a significant fall in the market share of banks, as nonbank financial institutions took advantage of the competitive disadvantage that regulations had imposed on banks. The growth of nonbank financial institutions made it more difficult to implement monetary policy through direct regulation.

In 1979, an inquiry into the Australian financial system (the Campbell Inquiry) was established with a wide-ranging brief to recommend...
Box 7.1 Regional Trade Liberalization

In the regional sphere, Australia remains one of the leading advocates of the Asia and Pacific Economic Cooperation (APEC) initiative. At the APEC meeting in Osaka in November 1995, leaders agreed on a set of principles to implement the objectives of free trade and open investment in the region by 2020 (2010, for industrial countries). The main principles include comprehensiveness (universal coverage of sectors), World Trade Organization (WTO) consistency, nondiscrimination, and standstill (a commitment not to impose new trade restrictions). From Australia’s perspective, agreement on the principle of comprehensiveness was essential to ensure that agriculture would not be left behind in the trade liberalization process.

Since 1983, bilateral trade relations with New Zealand have been progressively liberalized under the Closer Economic Relations Agreement. Trade in services has been free, except for sectors inscribed on “negative lists,” since 1989, and merchandise trade has been free of all quantitative and tariff restrictions since 1990. A major review of the agreement, conducted in 1995, focused on “third generation” trade facilitation issues, such as the harmonization of standards for food products and the mutual recognition of standards for other goods and professions. These were recently agreed in the context of the trans-Tasman Mutual Recognition Agreement. Furthermore, although a general “open skies” aviation policy is not being considered, an agreement was reached with New Zealand in late 1996 to establish a single aviation market in the two countries. Efforts to promote trade linkages and cooperation are also being pursued between the Closer Economic Relations partners and the members of AFTA (ASEAN Free Trade Area), and MERCOSUR (Southern Cone Common Market, including Argentina, Brazil, Paraguay, and Uruguay).

changes to the regulatory structure and to promote efficiency and stability. The final report of the Inquiry, presented in 1981, recommended four broad sets of changes: liberalization of the foreign exchange system; decontrol of domestic financial markets; strengthening of financial system regulations; and removal of barriers to entry to the financial system.

A great majority of the recommendations of the Campbell Report were implemented in the three years following the Inquiry. The exchange rate was floated and exchange controls were dismantled in December 1983; interest rates on government securities became market determined from 1982 onwards; quantitative controls on interest rates and portfolio composition were largely removed in 1982 (although a cap of 13½ percent applied to housing loans of less than $A 100,000

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until 1986); and new licenses were issued for foreign banks in 1985. Most reforms concerning stricter prudential supervision were implemented by 1986.

The authorities have also undertaken trade liberalization commitments in the World Trade Organization covering the financial services sector. An agreement was reached in July 1995 under which all participants offered to provide nondiscriminatory access to their banking, insurance, and securities markets according to a formally scheduled offer.

**Recent Deregulation**

In 1996, the authorities gave further impetus to these reforms by commissioning a fundamental review of the financial sector, known as the Wallis Financial Systems Inquiry. The Inquiry’s terms of reference required it to take stock of earlier reforms and recommend changes to the regulatory arrangements that would best promote the most efficient, responsive, competitive, and flexible financial system, taking into account the significant technological change in recent years. Of particular concern was the blurring of distinctions between banks and nonbank financial institutions, which meant that institutions offering similar financial products were subject to different regulatory regimes, hindering equal competition amongst them. At the same time, the emergence of financial conglomerates (partly in response to this blurring) meant that supervisors in individual sectors (for example, banking) were, individually, unable to obtain a complete picture of the financial health of the institutions they were assessing.

The Wallis Inquiry assessed the “successes and disappointments so far” flowing from the earlier reforms (Financial System Inquiry Report, 1997, Chapter 14). It noted that the “financial deregulation scorecard” is mixed, but on balance the financial system and wider Australian economy have enjoyed considerable benefits. The “successes” identified by the Inquiry include: greater choice and availability of finance at all levels; increased innovation and greater flexibility of services; closer integration with international capital markets; deeper financial markets; and improved cost efficiency in domestic markets and institutions. The “disappointments” include: excessive credit expansion in the mid-to late 1980s, coupled with declining lending standards that contributed to the 1991 recession; a rise in poor selling practices for some financial products (such as life insurance products); uneven levels of competition between sectors, with some sectors such as home mortgage lending seeing significant price competition only recently (more than a decade after the Campbell reforms were announced); and failure of for-
eign banks to have a competitive impact on the dominant position of Australian banks in the retail and small- and medium-enterprise markets.

The Inquiry recommended significant changes to the regulatory environment in its April 1997 report to the government. The government has adopted most of the Inquiry's recommendations. Most notably, it has replaced the four existing regulators with three agencies, removing the responsibility for supervising banks from the Reserve Bank, and placing it with a broad prudential regulator that will cover banks, other deposit-taking institutions, insurance companies, and superannuation (private pension) funds. In this way, regulatory differences across risk-taking institutions can be minimized, while supervisory work can be facilitated. To further promote competition while preserving financial stability, the reform measures will also reinforce supervision with increased public disclosure by financial institutions to promote transparency and help the public assess risk, liberalize access to the clearing system (thereby removing a barrier to competition between banks and nonbank financial institutions), and ease constraints on mergers and foreign ownership of the financial institutions. The government extended the existing depositor protection mechanisms of the Banking Act of 1959 (based on depositor priority over the assets of an institu-

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5The Reserve Bank is to remain responsible for monetary policy, overall financial system stability (including the provision of liquidity), and the regulation of the payments system. As part of this, a new Payments Systems Board is to be established within the Reserve Bank, with stronger regulatory powers to ensure safety, greater competition, and efficiency in the payments system. Two new bodies are to be established: the Australian Prudential Regulation Authority, which will prudentially supervise deposit-taking institutions, insurance companies, and superannuation funds; and the Australian Securities and Investment Commission, which will cover financial market integrity, disclosure, and consumer protection issues. The new regulatory agencies will have substantial autonomy.

6The government decided to end the "six pillars" policy, which involved a ban on mergers among the four largest banks and two largest life insurance companies. The government decided that mergers among the four major banks would not be permitted at this time, however, effectively establishing a new "four pillars" policy. The government stated that this policy would be subject to review when competition in the financial sector has increased sufficiently to allow mergers to be considered. Formally, provisions of the Trade Practices Act will now govern mergers among financial institutions, just as it does elsewhere in the economy. The government also decided to remove the prohibition on foreign takeover of any of the major banks. Any proposed foreign takeover will need to be assessed on a case-by-case basis in accordance with the Foreign Acquisitions and Takeover Act of 1975. In making these assessments, the government stated that it would apply the principle that any large-scale transfer of Australian ownership of the financial system to foreign hands would be contrary to the national interest.
tion) to all deposit-taking institutions to be licensed under the new regime.\(^7\)

**Public Enterprise Reform**

Public enterprises play a major role in the Australian economy, accounting for 11 percent of GDP and 14 percent of gross capital expenditure in 1995. Moreover, their operating surpluses are an important component of state government’s own-source revenue. Public enterprises—which numbered about 70 in 1996—are mostly owned by the states, primarily in the electricity, gas, water, and transportation sectors.

Since the late 1980s, important changes concerning public enterprises have taken place, mainly through privatization and corporatization, but also through changes in the regulatory framework. At the Commonwealth level, changes included the privatization of the Commonwealth Bank and the national airline, Qantas; the lease of Melbourne, Brisbane, and Perth airports, and the Australian National Railways Commission; and the sale of one-third of the Commonwealth-owned telecommunications carrier (Telstra). Current plans include the lease of a further 15 Commonwealth-owned airports and the sale of the Commonwealth’s interest in the National Rail Corporation.

At the state level, public enterprise reform has involved both corporatization and privatization, as well as deregulation of pricing (see Box 7.2).

**Competition Policy**

The reforms in competition policy and regulation of state-owned enterprises undertaken by individual governments since the late 1980s were given a common framework in 1995 by the introduction of a National Competition Policy, based on the work of the Hilmer Commission. The policy recognizes the costs of market dominance, especially

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\(^7\)The Australian Prudential Regulation Authority (APRA) will license and supervise deposit-taking institutions. The rationale for giving depositors first call or the assets of a failed financial institution, rather than adopting a formal deposit protection scheme, is that in the Inquiry’s view, this provides a sufficient level of depositor protection, while avoiding moral hazard issues associated with explicit deposit insurance. Moral hazard problems may also be lessened by the fact that in contrast to the central bank, the APRA has no balance sheet with which to reimburse depositors. Furthermore, the powers of the APRA will be strengthened relative to the current provisions of the Banking Act. In particular, the APRA will have the power to wind up a deposit-taking institution where it is not solvent and could not be restored to solvency in a reasonable period of time. The APRA will also have the power to direct or suspend operations of a deposit-taking institution where it has materially breached prudential regulations or standards.
Box 7.2 Public Enterprise Reform at the State Level

Since the late 1980s, state governments have begun to reform their public enterprises in order to improve their performance and strengthen their profitability. For the public-trading (notably, the utility and transportation) enterprises, a key objective was to reduce the cost of infrastructure provision and therefore the cost of inputs to the production process. Also, many public financial enterprises had accumulated sizable losses during the 1991 recession, which required significant capital injections by some state governments to repair balance sheets. Given this experience, many states concluded that the public benefits arising from continued state ownership were small compared with the risks involved.

In response, public-trading enterprises have been given incentives to improve efficiency and reduce costs. The reforms have included privatization, corporatization, pricing reforms, greater competition, and the introduction of tax equivalent payments and increased dividends to the government. In the financial sector, many state-owned banks and government insurance offices were simply sold in the early 1990s.1

Victoria has been the most ambitious state in terms of its privatization agenda. Aside from selling the State Bank of Victoria, it disaggregated the transmission and distribution of electricity into regionally based companies in 1993, corporatized them in 1994, and began to privatize them in 1995. Through the end of 1997, state-owned companies have been sold for about $A 31 billion, with about two-thirds of this coming from the sale of electricity companies by Victoria (Reserve Bank, 1997). Gas transmission and distribution have also been separated into discrete companies, and privatization is envisaged. In addition, access rights have been sold for some rail operations.2

1This included the State Bank of Victoria (sold for $A 1.6 billion), the Government Insurance Office in New South Wales in 1992/93 ($A 1.2 billion), the State Bank of New South Wales ($A 526 million), and the Bank of South Australia in 1994/95.

2In line with the goals of fiscal consolidation, the proceeds of asset sales have largely been used to reduce public sector debt.

by the large state-owned enterprises. Accordingly, it aims to introduce and foster competition where possible, and strengthen price regulation where it is not possible to introduce competition. Specifically, the legal reforms taken or envisaged as part of the National Competition Policy have the following implications:3

3This agreement was based on the recommendations of the 1993 Hilmer Report. See Hilmer, Rayner, and Taperell, National Competition Policy (Canberra: The Independent Committee of Inquiry, 1993)
• Public enterprises and unincorporated enterprises are now subject to the same rules and legislation of competitive conduct as all other enterprises.

• All Commonwealth, state, and territory legislation and regulations are being reviewed with regard to possible adverse impacts on competition. The Commonwealth and state governments have committed themselves to adhere to a timetable presented in 1996 and undertake the necessary reforms by 2000.

• Public monopolies are being reviewed to assess whether they are justified and do not unduly restrict competition.

• Access to essential infrastructure facilities that cannot be duplicated economically—for example, natural monopolies in electricity and gas distribution, and the railway system—is to be negotiated with third parties if such access improves competition significantly in a downstream or upstream market and the activity is of national importance.9

• Prices of government businesses with significant monopoly power will be reviewed on the basis of strengthened principles; this is particularly relevant to avoid excessive input prices for other sectors (many states already follow this practice).

• “Competitive neutrality” between public and private enterprises is to be ensured in sectors where they compete. This principle requires that the government ensure that public enterprises do not have an advantage over a potential or actual private competitor arising from their public ownership.10

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9The Industry Commission Annual Report (1995) notes that, with costs being lowest with only one service provider in cases of natural monopolies, such infrastructure services will continue to be provided by only one provider, but access to competitors may improve overall welfare by introducing competition in related areas. For example, competition in electricity generation may be welfare enhancing, but requires that electricity generators have access to the transmission grid. In granting access to such infrastructures, however, the Commission states that a careful balance must be struck between the benefits of enhanced competition in related areas and the costs that arise because infrastructure providers may be discouraged from setting up or expanding their facilities. The Commission notes that access shall be provided only if the gain in competition is significant and if third party access is required for effective competition.

10Specifically, areas that need to be addressed are: exemption of public enterprises from various taxes, access to borrowing at concessional interest rates, exemptions from complying with regulatory arrangements imposed on private competitors, and other benefits associated with not having to achieve a commercial rate of return on assets. Rules of implementation of the principle of competitive neutrality will vary among public enterprises. They could range from commercialization, legal changes, increased transparency to ensure that all costs are properly accounted for, removing taxation exemptions, subjecting public enterprises to similar borrowing costs as private sector businesses, and setting minimum rate of return requirements where applicable.
Box 7.3 Implementation of Reform in Specific Industries

Although competition policy reform legislation was not passed until 1995, reforms to certain industries—such as telecommunications and aviation—began in the early 1990s and plans for electricity, gas, and water reforms were drawn up in 1994. The following is a brief description of the competitive reforms undertaken or planned in certain key industries.

- **Electricity.** Electricity has been supplied by state government authorities on a monopoly basis, but now the aim is to establish a fully competitive national market for electricity with all customers having a choice of supplier. To do this, each jurisdiction is required to separate the generation, transmission, and distribution businesses and to corporatize them. Some have decided to privatize them. A competitive market in wholesale electricity has already been established in New South Wales, the Australian Capital Territory, and Victoria, forming the first stage of the nationwide grid, and interstate competition began in May 1997. The other states and territories are moving more slowly, but in the same direction. The National Electricity Code Administrator has been established to administer an industry code of conduct consistent with the general principles of the National Competition Policy, and the Australian Competition and Consumer Commission is responsible for regulatory oversight.

- **Gas.** Gas has been supplied through a monopolistic mixture of private and public sector ownership, but legislative and regulatory barriers to trade in natural gas have now been removed and a uniform national framework for third party access to both inter- and intrastate supply networks has been established. Furthermore, publicly owned gas utilities will be placed on a more commercial footing through, among other ways, the vertical separation of transmission and distribution activities. Major gas users are expected to be able to choose their supplier by mid-1998, and all users will have choice by mid-2002, in most states.

- **Water.** Reforms for urban water, scheduled to be carried out by the end of 1998, include the removal of cross-subsidies, and a shift to a “pay-for-use” basis for pricing; reforms for rural water supply, scheduled to be implemented by 2001, focus on changing the pricing regime to enable the industry to recoup operations and maintenance costs.

- **Telecommunications.** Deregulation of the telecommunications industry began in 1991 with the introduction of a carrier duopoly to replace the incumbent monopoly, Telstra. A triopoly was introduced in the market for mobile telephones. From July 1, 1997, full and open competition in telecommunications was introduced with no restriction on the number of providers or installers of network infrastructure, and no industry specific

Implementation of the national competition policy has already begun. Legislation has now been passed so that the conduct code agreement of the Trade Practice Act now applies to all areas of the economy. The Com-
limits on foreign investment in new carriers (the standard provisions of the Foreign Acquisitions and Takeovers Act, however, will apply). The government sold one-third of Telstra in November 1997, the largest public float ever to occur in Australia. Foreign ownership in Telstra is restricted to 1.67 percent for individual foreign investors and 11.67 percent for foreign investors as a class.

- **Aviation.** During the 1980s, a series of reviews mapped out the reform agenda for aviation. As a result, aviation infrastructure services were taken out of the hands of a government department and became the responsibility of corporatized agencies; operational restrictions were relaxed enabling new airlines to operate on most of Australia’s major domestic routes; and agreements covering Australia’s international air services were renegotiated, increasing the available capacity and ending Qantas’ position as Australia’s sole international carrier. In addition, the Commonwealth government privatized Qantas and in 1996, Australia and New Zealand agreed to establish a single aviation market in the two countries. Looking ahead, Australia plans to adopt a more open charter policy, to continue to pursue increases in exchanges of capacity entitlements and expansion of route rights, and to support initiatives coming out of the APEC group on more competitive air services. It will continue to progressively liberalize access to the Australian aviation market in freight and passengers. The government is also to lease (for a 50-year period) major airports to private operators. The first three major airports (Melbourne, Brisbane, and Perth) were leased during 1997 and current plans call for the leasing of a further 15 airports.

- **Maritime.** A reform agenda is being undertaken that will include a review of the anticompetitive provisions of the Trade Practices Act that provide certain exemptions for some agreements between shipping companies; possible wind back of cabotage protection that restricts the use of foreign vessels in Australia’s coastal waters; a review of the requirement for majority Australian ownership for Australian registration of ships; and a review of technical standards and practices to ensure they are transparent, applied consistently, and are consistent with recognized international standards and practices.

- **Railways.** The Commonwealth government has sold the businesses of the Australian National Railway and intends to sell its shareholding in the National Rail Corporation (which it jointly owns with the New South Wales and Victorian governments). Some states have split the rail system into entities for passenger transport, freight transport, and infrastructure access to improve the commercial focus of the system where possible.
sarily inhibit competition; set out how government will ensure competitive neutrality between the public and private sector businesses; and, for the states and territories, explain how policy will be applied to local governments. Some examples of sectoral reform are given in Box 7.3.

Related to implementation of the National Competition Policy, the government embarked on a Corporate Law Economic Reform Program in 1997. The stated aim of the program is to ensure that Australia’s corporate law encourages companies to fulfill their role of facilitating investment, employment, and wealth creation, while maintaining investor confidence. Principles underpinning the reform include reducing transaction costs for firms and market participants; striking an appropriate balance between government regulation and industry self-regulation; removing barriers to entry for service providers; and improving harmonization of Australia’s regulations and laws applying in major world financial markets. Priority areas for reform relate to regulations concerning takeovers, capital raising, futures and securities markets, directors’ duties, and electronic commerce. The government also intends to address the reform of Australian accounting standards.

What Has Been the Result of the Reforms So Far?

The benefits from the reforms have been clear and large at the microeconomic level. In every sector, efficiency has improved, allowing prices to decline and profits to increase. These benefits are likely to be widely distributed because the broad base of the reforms ensures that sectors that lose from one reform gain from others.

A particularly marked productivity improvement has occurred in the state-owned enterprises. From 1990 to 1995, output prices fell by 10 percent in real terms, while profits increased and the total amount payable to the governments (taxes, tax equivalents, and dividends) rose by 85 percent in real terms—from $A 2.1 billion to $A 3.9 billion. The strongest increase was in the electricity, gas, and port sectors (Steering Committee on National Performance Monitoring of Government Trading Enterprises, 1996, p. 7).

In the electricity sector, real electricity prices for businesses fell by 13 percent from 1990 to 1995; they have, however, risen slightly for households (3 percent) as existing subsidies have been unwound. 11 Despite the

11 This increase also reflects the decision of the state of Victoria to pass benefits to taxpayers, not to consumers, causing electricity prices for households to rise by 15 percent. In the other states, average electricity prices to households fell by 1.5 percent (Industry Commission, Annual Report 1995/96, p. 20).
decline in prices, returns have increased. In New South Wales, for example, average real output prices fell by 4 percent from 1988 to 1994, but dividends from the electricity company rose from zero to $A 0.6 billion.

In the telecommunications sector, the introduction of competition in long-distance services in 1992/93 led to a decline in the price of a representative long-distance call of 20 percent and of an international call of 16 percent within one year (EPAC, 1994, p. 2). In 1994/95, the reduction in telephone rates was estimated to have reduced consumers' expenditures by $0.5 billion (Productivity Commission, 1996, p. 30). The reductions in prices of Telstra's services in the 1990s were accompanied by significant increases in profitability (reflected in higher dividends and corporate tax payments) and by improved quality and responsiveness of service (Commonwealth of Australia, 1996a).

Aviation reforms led to a decline in real ticket prices of 25 percent from 1990 to 1993 (EPAC, 1994, p. 2), while output, employment, and productivity in the sector surged. Significant gains were also evident in the transport sector. Railways have moved to more cost-reflective prices. Non-urban passenger fares rose 18 percent in real terms and average freight rates fell by around 12 percent in the five years to 1994–95 (Productivity Commission, 1996, p. 30).

The gains from continuing the reforms across a broad range of sectors, with full implementation of the National Competition Policy, are likely to be considerable both at the microeconomic and macroeconomic level. The benefits of the reforms at the macroeconomic level are discussed in the next chapter, which also assesses the medium-term outlook for potential growth.

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