Speech to the ACCC/AER Regulatory Conference 2015

John A. Fraser | Secretary to the Treasury

6 August 2015

Tonight, I want to speak to you about the importance of competition for the Australian economy and also say a few words about its relevance for infrastructure reform.

At Treasury we provide advice to Government on competition laws and policy, alongside our responsibilities in areas such as macro, financial, structural, social, fiscal, tax and international economic policy.

We also provide advice on Commonwealth infrastructure investment decisions, Commonwealth-State relations and deregulation policy.

Quite simply, we cover the waterfront and, in so-doing, competition is a pervasive force in our thinking.

One needs to be careful with slogans but in approaching these issues Treasury is a Department that is proud to be fiscally conservative, market-oriented and reform-driven.

The reality is that competition is at the heart of how we organise ourselves as a society.

Competition is about deciding what to produce based on willingness to pay, through free exchange.

For the liberal ethicists out there, it appeals to our sense of freedom and justice: our right to do business where, with whom and for what we want.

But when we look back at competition reforms in the 20^{th} Century, it was the evidence from the real economy rather than philosophy that convinced people about the need for reform.

Competition won because it works.

Competitive markets generally deliver benefits for all Australians in a way that sheltered markets fail to do so.

Not always — and I'll say a few more words about that later — but almost always.

Effective competition in our economy is a key part of its strength and dynamism.

Competitive markets benefit consumers by putting downward pressure on prices.

And over time, competitive pressures drive innovation and investment in new technologies and the development of new products and quality services that meet the needs of consumers.

This process of innovation is what drives economic growth and improvements in living standards in the long term.

To better understand the benefits of competitive markets we should reflect on where we have come from.

Competition reform in Australia is a four decade-old project.

Gough Whitlam cut tariffs in his 1973 Budget. This was a move that surprised almost all political commentators at the time, not least me, in the first year of my professional career at Treasury.

And so began the modern era opening of Australia to the world economy.

The process of market liberalisation accelerated through the 1980s and into the 1990s.

Successive tariff cuts put Australian manufacturing under increased competitive pressure but, behind the border, changes gave manufacturers flexibility to respond.

Significant among these changes were financial market deregulation and the move to enterprise bargaining, as well as the oft-forgotten reductions to the top personal marginal tax rate from a high of 60 per cent in 1985-86 and to 47 per cent in 1990-91.

The process of reform culminated with the agreement across all levels of government to form the National Competition Policy.

Government businesses were restructured to make them more commercially focused.

The electricity, gas, water and rail sectors were transformed.

Legislation was reviewed so it enhanced rather than restricted competition.

And a national access regime was established for essential infrastructure.

Signed in 1995 and extending through to 2005, the National Competition Policy saw Commonwealth, State and Territory governments review around 85 per cent of legislation identified as potentially anti-competitive and, where appropriate, introduce pro-competitive reforms.

Where creativity was once stifled by regulation, competition in product and service markets drove management to change work practices.

A liberalised financial sector and a sound macroeconomic environment supported strong investment.

The Productivity Commission estimated that productivity improvements in key infrastructure sectors in the 1990s — that were targeted by National Competition Policy and related reforms — increased Australia's GDP by 2.5 per cent.

Australia's productivity grew faster in the 1990s than in the two decades prior, or the decade and a half since.

For a brief while, Australia became a productivity growth leader, rather than a laggard.

Looked at through a different lens, these reforms were about driving down the cost of doing business in Australia.

Lower transport and utility costs, lower tax rates, cheaper access to capital and more flexibility to move labour around.

These reforms can equally be credited with making Australian industries more internationally competitive.

It is hard to overstate the magnitude of these changes.

They continue to set the benchmark for us today — not just in terms of economic impact — but they also serve as a lesson about getting policy reform done.

I want to mention three features of that time.

First, it was a holistic set of structural reforms.

This is important because winners and losers differed and all Australians benefited from at least some of these reforms.

Second, in order to achieve reform we built a political consensus and, more importantly, a community consensus that things had to change and that a delay would make matters worse.

Third, the business community – both large and small – was a big part of this changing culture.

Managers, no longer distracted by currying government protection, were better able to focus outwards on new markets and inwards on cost savings.

As I have said before, we could be accused of having become complacent since the mining boom.

The Australian economy is now entering its 25th consecutive year of growth.

The recent Budget economic forecasts describe a relatively positive short-term economic outlook and, especially so, compared with most developed economies.

Data since the Budget have been mixed – some stronger, some a little weaker.

Importantly, the strong data include the labour market and the June quarter retail sales as well as the US economy.

Of course, we have been watching closely the Greek tragedy and also the stock exchanges in Shanghai and Shenzhen.

Broadly, those developments haven't affected our positive view on Australia's economic outlook.

We will next revise our forecasts at MYEFO. As usual, in informing our view, we will have numerous discussions with industry, our overseas counterparts, as well as careful consideration of interim data releases.

When you look across the Australian economy — the high profit share of GDP, the weaker exchange rate, low interest rates and slow growth in wages — I have to say that I'm disappointed we are yet to see stronger investment intentions.

These are good times for those who invest for the longer term.

That said, current rates of average labour productivity growth remain well below the rates — around 2½ per cent — experienced in the late 1990s and early 2000s.

The mining boom masked the impact of this productivity slowdown by keeping average income growth high.

But, as the terms of trade fall, we are now seeing the effects of lower productivity growth.

What we have seen is that Australia's national income per person has been essentially stagnant for four years.

The Intergenerational Report — or IGR — makes clear that productivity growth will be the predominant means of improving our material living standards over the long run.

Growth projections in the IGR rest on an assumption that over the next 40 years we will achieve the same 1½ per cent annual labour productivity growth as we did over the past 30 years.

The past 30 years, however, included the major reform streak that I have already mentioned.

And past performance is no guarantee of future results.

The chance of us achieving this moderate projected rate of growth is smaller without ongoing reform.

Unless we lift productivity growth, through reforms across all sectors of our economy, we face prolonged stagnation in living standards not seen before in this country.

The good news is that there's plenty to get on with.

Tax reform, for one.

We know how Singapore's competitive tax rate helped to make their country a hub for global finance and trade.

But Australia is not just competing with Singapore on tax rates but countries such as the UK, Hong Kong, the Gulf and New Zealand.

And there is the financial system.

Australia's banking sector is relatively concentrated by international standards and the Financial System Inquiry recommended regulators better balance competition against their other objectives.

And labour market reform too.

As I have recently noted, we need to consider seriously our labour market settings and the need for workplace relations reform.

In this regard, I am heartened by Peter Harris and the Productivity Commission's draft report on workplace relations, released on Tuesday.

Genuine reform of workplace relations can be expected to have positive effects on employment and productivity and to reduce business compliance costs.

One of the reasons reform in these areas are important is because they strengthen competition.

Australia has some unusually highly concentrated markets.

To the extent that these structures reflect economies of scale, for example based on highly sophisticated national logistics networks, they may bring benefits to Australian consumers.

But it is important that firms that have market power are not able to use that position to exclude competitors and potential competitors.

This is why we have competition laws.

The Harper Review Panel found that the current competition laws need to be overhauled to make them fit for purpose.

Of course, you'll all be aware that one issue has attracted particular attention, and that is Harper's recommendation on section 46.

This is an important issue. The misuse of market power provision is a necessary part of our competition law.

The 'take advantage' element of section 46 is a product of the 1960s, well before any serious thought of competition was alive.

By recommending a test based on 'substantial lessening of competition', Harper was aiming to promote pro-competitive conduct like innovation and vigorous price competition.

The intention behind the Harper Panel's recommended change is to improve the clarity and effectiveness of the law so as to deter corporations with substantial market power from engaging in exclusionary or anti-competitive conduct.

There are, of course, others who take a different and considered view of the changes proposed by the Harper Review.

Whatever – it is great to see competition policy the subject of lively public debate.

We also need to think seriously about regulatory restrictions on competition.

Despite the substantial reforms of the 80s, 90s and early 2000s, submissions to the Harper Review also raised many examples that are important for all governments to consider.

The Harper Review recommended that all Australian governments should review regulations to remove unnecessary restrictions on competition and thereby improve the productivity of our economy.

There remain substantial restrictions on who can supply goods and services, including: professional licensing requirements; liquor and gambling regulation; media and broadcasting restrictions; and the well-known issues of pharmacies and taxis.

There are restrictions on what can be supplied: through product standards; agricultural marketing boards; parallel import restrictions; and intellectual property protections.

And restrictions on where and when supply can occur: air service agreements; retail trading hours restrictions; and planning and zoning rules.

Not all of these areas individually have the potential for really big economic impacts, of course.

And the goal here should not always be deregulation — regulations are often justified to pursue social goals.

But these goals should be approached through better regulation that doesn’t have the side effect of curtailing competition.

To my mind, foremost among this list, for immediate economic bang for the buck, is planning and zoning.

Planning and zoning systems, in many cases, create excessive barriers to entry of new businesses by limiting the number and size of outlets and the types of business models permissible.

This has the effect of stifling innovation, making suppliers less responsive to the needs of consumers.

Victoria to its credit has led the way in terms of reducing the number of different zones and expanding the range of activities allowed within each zone.

Estimates from the Centre for International Economics in 2013 suggest that similar reforms in New South Wales alone could add between $½ billion and $1½ billion to that State’s economy.

This is a priority we should all get behind.

Indeed, it’s unfortunate that sometimes this is seen as a big business versus small business issue.

The same planning systems that delay the entry of big businesses also delay the expansion of shopping space, leaving some small businesses in poor bargaining positions with landlords.

In other areas, the challenge for governments is not so much to reform regulation as to make way for ‘digital disruption.’

Uber is connecting passengers with drivers; and AirBnB is connecting travellers with spaces.

In many ways, these platform providers play the role of regulators: ensuring supplier credentials; providing basic consumer protections; and facilitating community assessment of service quality, through continuous feedback.

We should welcome competition here too — governments should not be too quick to assume they will always be better regulators than the private sector.

Continuing this theme, the Harper Review also makes the case that we need to be more creative if we are to meet the challenges of an ageing population with high quality services tailored to their needs.

Reforms in this area have already begun.

For example, under the National Disability Insurance Scheme (or the NDIS), funding for disability support will follow individual service users rather than providers, allowing individuals to choose the service providers they want.

There won't just be one model of user choice.

In our schools, effective choice may come down to making sure schools are able to respond to the needs of students and families in the local community.

As a former board member of a girl's school in London, I am acutely aware of the benefits of greater freedom for schools.

The UK has endeavoured to increase the autonomy that schools can exercise.

My school was competing with other private and public schools and was very successful, particularly due to our freedom to hire a terrific principal.

Oversight from Ofsted — the Office for Standards in Education, Children's Services and Skills — ensured that our school, like all schools in the UK, was accountable for the performance of our students.

Of course, competition doesn't *always* work where there is not a contestable market.

In addition, in exceptional circumstances, where consumers are too poorly placed to make choices for themselves, for example, markets need to be carefully designed and there will remain a strong role for government.

What the Harper Review says is that empowering consumer choice between a diversity of service providers should be the default approach.

The onus should be on those who favour a different model — such as direct government service delivery — to make the case.

Progress will come from trialling different approaches, assessing their effectiveness and sharing those learnings throughout the system.

Like competition, efficient infrastructure delivery is central to economic growth.

With our large population centres separated by vast distances, transport infrastructure is critical to sustaining Australian communities.

It's about building an integrated economy — just as the Eisenhower Interstate Highway System did in the USA — by cutting the costs of transporting raw materials and manufactured goods around the country.

For Australia, the Productivity Commission found in 2014 that infrastructure reform would produce large economic benefits.

Just by reducing the costs of delivering infrastructure, the PC found that we could achieve $1 billion in annual savings.

For new investments, we need to choose the right projects.

Poorly selected public infrastructure investment can crowd out private investment and reduce productivity.

We have to ensure that we select the right projects at the right time, pay the right price for them and charge the right price for services provided.

In Australia, however, new infrastructure isn't the solution to everything.

Of key importance, too, is the delivery and pricing of services from existing infrastructure.

It's vital that we consider if we can do more with what we already have.

The lack of a price signal in the roads market means that there is only a weak link between consumer demand and spending decisions.

And this means excessive congestion costs.

No one really knows how large they are. But estimates suggest congestion now roughly costs around $14 billion a year.

If no action is taken, this could increase to $53 billion by 2031.

Whilst these are simple estimates, they give us a sense of the consequences we might face without considering infrastructure reforms and the huge benefits available by doing things better.

For Treasury, this has a regional and international dimension.

Treasury will be managing with the States and Northern Territory the Government's $5 billion Northern Australia Infrastructure Facility – the NAIF – to help get projects off the ground and increase the productive capacity of Northern Australia.

The north enjoys competitive and strategic advantages, many of which have been underutilised.

It is close to South East Asia and has well-established resource and agricultural industries.

Treasury will draw on professional investment expertise to scrutinise rigorously all potential investments and for that reason I plan to run the facility from our Sydney Office.

The Global Infrastructure Hub is likewise a significant development in infrastructure reform.

Last year, as part of broad efforts to lift investment in quality infrastructure, the G20 leaders gave the Hub a mandate to — address data gaps; lower barriers to investment; increase the availability of investment-ready projects; help match potential investors with projects and improve policy delivery.

Australia has made considerable progress in establishing the Hub in Sydney.

Christopher Heathcote has been appointed as the CEO and I chaired the first meeting of the permanent Hub Board in April 2015.

We will hold the second meeting of the Board in Ankara next month around the G20 meetings.

The Australian Government is a major contributor to the Hub, providing $30 million over five years.

We have also secured financial backing from the UK, China, Saudi Arabia, New Zealand, the Republic of Korea, Mexico and Singapore, which together total about $20 million.

The Hub has international support and is already working closely with private sector, development banks and international organisations to help unlock an additional $2 trillion in global infrastructure investment to 2030.

Through Treasury's involvement with the Hub and the NAIF, we will continue to beat the drum on the need for quality infrastructure projects.

When I started these remarks, I said that I was going to talk about competition.

I could instead have given a speech about the problems of market power.

Market power prevails in too many Australian markets.

We have health and education sectors in which services are still delivered to a material degree by public servants.

Similarly, road construction remains dominated by bureaucratic decision making, rather than being driven by market incentives.

The best of all monopoly profits is a quiet life.

For a long time, Australia chose to put up the walls to competition and lock in the privileges of Australian monopolies.

We were the lucky country and we could afford to ride on the sheep’s back.

And, for a long time, Australia’s economic performance disappointed.

Through the work of many — and the leadership of a small number of eminent people — a new culture of competition took hold through the 1980s and 1990s.

Now, as Australia emerges from the largest mining boom in its history, we face a similar set of challenges and face remarkably similar choices.

We should not succumb to the view that the reforms available to Australian governments are ‘too hard’ — and leave them for another generation to handle.

Thank you.