

# Competition Policy Review – NSW Government Submission

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## Executive summary

The NSW Government is firmly committed to improving competition across the public and private sectors. Effective competition, and the innovation it inspires, is a critical driver of productivity and economic growth.

The current Competition Policy Review is an opportune time to reinvigorate the microeconomic reform agenda, given Australia has experienced a decade of declining productivity growth, and faces a period of structural change.

For reform to be meaningful there needs to be a renewed commitment to reform by all levels of government, underpinned by clear competition principles that are relevant to today's economy. Consideration should also be given to the definition and application of the public interest test to ensure it is effective in the reform process.

This submission focusses on four key areas:

1. A new competition reform agenda that is supported by an institutional structure that ensures jurisdictions are committed, the benefits of reform are shared and reform momentum is maintained.
  - An independent national body should be tasked with the responsibility for monitoring progress in implementing reforms, periodically identifying areas for competition reform, making recommendations on these areas to governments, and playing an advocacy role.
  - To facilitate and lock-in reforms, financial incentives should be considered as they can help to share the economic growth and revenue benefits from competition reforms in a way that is proportionate with reform effort and outcomes.
2. Governments have an important role to play through removing existing regulatory impediments to competition and preventing new ones in both the public and private sectors.
3. Increased competition and innovation in public service provision can deliver significant benefits, and NSW believes that strategic commissioning is the most effective way to realise those benefits (such as achieving better value for money while improving service quality, creating contestability and incentives to innovate, and increasing accountability and transparency).
4. Governments need to keep in mind the rapid pace of change created by technological improvements and make regulatory decisions that do not impede future innovative activity in the economy. Regulations need to be adaptive so that they do not stifle competition in a way that ultimately is to the detriment of consumers.

## Summary of recommendations

### Principles, governance frameworks and incentives

1. All governments should re-commit to a revised set of competition principles to guide competition reform, updating the national 1995 *Competition Principles Agreement*.
2. The Review Panel should consider the mechanisms that are required to ensure ongoing compliance with competition principles.
3. The Review Panel should consider the definition and application of the public interest test established by the *Competition Principles Agreement* to ensure it is effective in the reform process.
4. The review of the competition principles should also consider the adequacy and effectiveness of existing competitive neutrality principles.
5. An independent national body should be tasked with the responsibility for monitoring progress in implementing reforms, assisted by a competition policy agreement, periodically identifying areas for competition reform, making recommendations on these areas to governments, and playing an advocacy role.
6. The provision of financial incentives from the Commonwealth to the States would help facilitate and lock-in reforms, and share the economic growth and revenue benefits (which would largely be captured by Commonwealth tax bases) in a way that is proportionate with reform effort and outcomes.
7. The incentive mechanism should be institutionalised through an agreement between the Commonwealth and the States.
8. Principles should be established to underpin any financial incentive payments. The principles should set out how the benefits from future competition reforms should be shared, acknowledging implementation costs and distributional impacts and be calibrated to realised achievements, and not forecast activity.
9. The Productivity Commission should be tasked with determining the growth and revenue impacts of any future reform package to inform an agreement on financial incentives, taking into account adjustment and distributional issues.
10. An accountability mechanism should be introduced alongside the financial incentive payments. This could take the form of public reporting by the independent body on jurisdictions' reform progress, highlighting where insufficient progress has been made.
11. The design of the institutional framework to implement reform, including financial incentive payments, should be informed by the experience of past rounds of national reform to ensure new arrangements are as effective as possible. The arrangements should be designed so as to ensure jurisdictions retain flexibility in the implementation phase of individual reforms.

12. The Productivity Commission needs to be tasked to prepare a five-yearly report on Australia's productivity performance, factors impeding productivity growth (including impediments to competition), and the future direction for productivity-enhancing reform.

### **Commonwealth and State regulatory impediments to competition**

13. The Review Panel should emphasise that a future competition reform process should consider industry assistance to ensure that its design principles do not impede competition and contestability, but generate a net social benefit.
14. The Review Panel should consider the extent to which price regulation across a range of sectors encourages or inhibits competition.
15. The Review Panel should identify areas where regulatory overlaps between jurisdictions can be reduced. The Federation White Paper will also provide an opportunity to address better ways of streamlining joint Federal/State roles.
16. For areas where there is regulatory overlap, it is important to consider whether regulations should be streamlined to reduce duplication, whether it is necessary to have regulators across different levels of government, and consider which level is appropriate.

### **New challenges**

17. Governments could consider developing their own strategic commissioning frameworks to apply across all areas of public service provision including utilities, transport and social and community services. Governments could share experiences and cooperate on strategic commissioning implementation as appropriate.
18. The Review Panel should consider how jurisdictions and competition frameworks can best anticipate and respond to digital technologies and product innovation – recognising that these developments can bring both opportunities to enhance competition and policy challenges for existing laws and regulations.

## Introduction

The NSW Government is committed to improving competition across the public and private sectors. Effective competition is critically important because it is a key driver of productivity and economic growth. Firms that operate in a competitive environment have an incentive to increase their efficiency and innovate. Competition also ensures that markets are dynamic, where productive, innovative firms grow and expand their market share. In markets that are competitive, the prices consumers and businesses face are lower, and consumers have more choice across a better range of goods and services.

The benefits competition can provide are significant:

- Reforms introduced to increase competition as part of the National Competition Policy (NCP) in the 1990s helped to boost Australia's gross domestic product (GDP) by 2.5 per cent (around \$20 billion).<sup>1</sup>
- The NCP reforms led to significant increases in the productivity performance for specific industries:<sup>2</sup>
  - removing entry restrictions in the telecommunications market and introducing an industry specific access regime increased multifactor productivity (MFP) by around 7 per cent a year between 1996-97 and 1999-2000;
  - structural separation of public monopolies in rail freight and passenger services and the introduction of third party access arrangements raised MFP by an average of 8 per cent a year between 1989-90 and 1997-98; and
  - the introduction of contestability in non-standard letter delivery in postal services increased MFP by an average of 3.5 cent a year over the decade to 2001-02.
- The NCP reforms also contributed to a reduction in real prices for several infrastructure services, including:
  - port service prices fell by up to 52 per cent over the decade to 2000-01;
  - rail freight charges decreased by up to 42 per cent between 1995-96 and 1999-2000;
  - telecommunications prices fell by up to 29 per cent between 1996-97 and 2002-03; and

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<sup>1</sup> Productivity Commission, *Review of National Competition Policy Reforms*, Report no. 33, Productivity Commission, Canberra, 2005, p. xvii.

<sup>2</sup> *Ibid*, p. 46.

- electricity prices declined by 19 per cent, on average, between 1990-91 and 2003-04.<sup>3</sup>
- Financial sector deregulation, including liberalising foreign investment has: improved the efficiency and competitiveness of the financial sector; made Australian capital markets more internationally integrated and competitive; and provided households with greater access to financial intermediation.<sup>4</sup>

Since the reforms of the 1990s, the progress on implementing reforms to boost competition has slowed across all levels of government in Australia.

The current Competition Policy Review (the Review) provides an opportunity to reinvigorate the microeconomic reform agenda across the nation. This is timely given Australia has experienced a decade or so of declining productivity growth, and faces a period of structural change as the investment phase of the mining boom comes to an end and the economy shifts away from mining-led growth. Getting the settings right now will facilitate the flow of resources freed up from the end of the mining construction boom to the most efficient use. This will have dividends for years to come. In this context, competition policy reform can play a critical role in boosting productivity growth and living standards.

Governments have an important role to play by fostering competitive markets through removing regulatory impediments to competition in both the public and private sectors. Reforms to increase competition help to remove market distortions and allow resources to flow to the areas of highest return.

Governments have a number of policy levers available to influence competition, including competitive conduct rules, regulation review processes, restructuring principles, access regimes, price surveillance and competitive neutrality regimes. However, any government intervention needs to be based on an understanding of the way policies can best promote the public interest. The NCP reforms were underpinned by the ‘public interest test’; this Review is an opportunity to revisit the test to ensure that it is effective in the reform process.

The NSW Government is committed to improving competition: it has introduced a range of reforms to improve competition in private markets. For example, it has committed to removing price regulation on electricity on 1 July 2014, reduced the regulatory burden in the motor vehicle repairs and poultry industries, committed to repealing NSW licensing requirements for the refrigeration and air conditioning occupations, and imposed a cap on the electronic payments surcharge for taxis.

The NSW Government has also introduced a number of changes to increase competition in public markets, through improving the way it delivers and procures goods and services,

<sup>3</sup> *Ibid*, p. 56.

<sup>4</sup> Boyton, A. 1997, Liberalisation of Foreign Investment in the Australian Financial Sector, The Treasury, Canberra.

and increasing contestability in public service delivery. These changes help to achieve better value for money while improving service quality, create incentives to innovate, and increase accountability and transparency. The Government is developing a strategic commissioning framework as a way of implementing this concept more broadly.

Strategic commissioning means working out the services the community needs, whether there is a role for government in providing these services, and then designing the best service delivery system. Strategic commissioning is not code for outsourcing; while the NSW Government supports increased competition in the provision of public services, a one-size-fits-all approach is not appropriate.

The NSW Government has implemented a range of different delivery models. Recent examples include the new Northern Beaches Hospital public-private partnership (PPP), which involves an innovative purchasing of services, social benefit bonds to deliver early intervention and prevention programs, introducing contestability in road maintenance and non-emergency patient transport services, and shifting to a franchise model for Sydney Ferries. As these examples demonstrate, there is considerable scope for governments to promote increased competition in the delivery and procurement of government services.

# Principles, governance frameworks and incentives

## Competition policy principles

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The competition policy principles agreed by all governments in 1994 were a critical driver in implementing the NCP reforms in that decade. Since that time, there have been significant changes in the economy, including changes in markets, industry structure, the way in which transactions take place and technological developments. It is necessary to review and where appropriate update the competition principles to ensure they remain relevant in today's economy and are sufficiently flexible to withstand future developments.

A key outcome of the Review should be that all governments re-commit to a contemporary set of competition principles to guide competition reform. The Review should also consider the mechanisms that are required to ensure ongoing adherence with competition principles. For example, this might require an independent oversight body, and may include ongoing financial incentives (discussed in more detail below).

The competition principles should also consider what genuine competition looks like from both the demand side (how consumers exercise choice) and the supply side (incentives for service providers).

The United Kingdom's Office of Fair Trading (OFT) suggests that the following principles should underpin government intervention in markets; governments should consider:

- policy responses from both demand side (to influence consumer behaviour) and supply side (to influence business behaviour);
- how a proposed policy is likely to affect market entry and exit, the nature of competition in the market and the ability of consumers to exercise choice; and
- the policy responses that will least restrict competition, including market-based approaches and self-regulation.<sup>5</sup>

Any Government intervention to promote competition needs to be based on an understanding of the way in which policies can best promote the public interest. The public interest test plays an important role in balancing public policy objectives, such as safety and consumer protection, against the costs imposed on businesses and consumers by regulations that restrict competition. In some cases there will be a net public benefit in maintaining the existing regulatory intervention. For example, there is likely to be a net public benefit in:

- land use restrictions that limit building in bush fire or flood prone areas;
- work health and safety regulations that reduce the risk of injury and illness; and

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<sup>5</sup> OFT, *Government in markets: Why competition matters – a guide for policy makers*, OFT, London, 2009.

- vehicle safety standards that reduce the risk of traffic incidents and fatalities.

### **Box 1: Public interest test**

Clause 1(3) of the *Competition Principles Agreement* signed on 11 April 1995 between the Commonwealth and State and Territory Governments sets out the public interest test as follows:

Without limiting the matters that may be taken into account, where this Agreement calls:

- (a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or
  - (b) for the merits or appropriateness of a particular policy or course of action to be determined; or
  - (c) for an assessment of the most effective means of achieving a policy objective;
- the following matters shall, where relevant, be taken into account:
- (d) government legislation and policies relating to ecologically sustainable development;
  - (e) social welfare and equity considerations, including community service obligations;
  - (f) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
  - (g) economic and regional development, including employment and investment growth;
  - (h) the interests of consumers generally or of a class of consumers;
  - (i) the competitiveness of Australian businesses; and
  - (j) the efficient allocation of resources.<sup>6</sup>

A review of competition principles should revisit the public interest test set out in the 1995 Competition Principles Agreement (Box 1) to ensure that the definition of public interest and the application of the public interest test is effective in the reform process. This review should consider whether the definition of public interest can accommodate changes in social values, and how the public interest test has been applied in practice. This is particularly relevant given the Productivity Commission found that the:

- public interest test requirements were not always rigorously applied in the legislative reviews that took place as part of the NCP;
- onus of proof was not appropriately assigned (parties seeking to retain anti-competitive restrictions were required to prove that removing the restrictions would not be in the public interest); and

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<sup>6</sup> Council of Australian Governments, *Competition Principles Agreement – 11 April 1995 (As amended to 13 April 2007)*, 2007.

- guidance on how to estimate costs and benefits and how the public interest criteria should be weighted was insufficient.<sup>7</sup>

The lack of guidance on estimating costs and benefits may have led to an increased focus on certain aspects of reform (for example economic factors) at the exclusion or perceived exclusion of other considerations (for example social issues). There could be benefit in developing common guidance on how to assess the public interest and balance competing criteria.

A review of competition principles should also consider the operation and adequacy of the competitive neutrality principles, and whether they need to be updated. In particular whether they are being applied effectively in practice and if mechanisms are required to ensure ongoing compliance and commitment to the principles.

## **Recommendations**

1. All governments should re-commit to a revised set of competition principles to guide competition reform, updating the national 1995 *Competition Principles Agreement*.
2. The Review Panel should consider the mechanisms that are required to ensure ongoing compliance with competition principles.
3. The Review Panel should consider the definition and application of the public interest test established by the *Competition Principles Agreement* to ensure it is effective in the reform process.
4. The review of the competition principles should also consider the adequacy and effectiveness of existing competitive neutrality principles.

## **Governance frameworks**

Robust governance and institutional arrangements will be critical to the success of the next wave of competition reforms. The National Competition Council (NCC) played an important role in the successful implementation of the NCP reforms. A similar independent body will be required to oversee the next wave of competition reform.

The role of this body would be to:

- provide independent monitoring of progress in implementing reforms according to agreed timetables, providing public accountability and transparency;
- have an ongoing role in periodically identifying areas for competition reform across all levels of government, recognising the changing environment in which markets operate;

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<sup>7</sup> *Ibid*, p. xxiv.

- make recommendations to governments on areas for reform; and
- play an advocacy role, similar to the NCC, including communicating with the public and demonstrating how reforms are in the public interest.

The advocacy role is particularly important given that the case for reform can be difficult to make as the benefits of reform are often diffuse and spread over time, while any adjustment costs can be evident more quickly and be concentrated among a smaller group of stakeholders.

It is envisaged that the role of this body would be distinct from the existing roles of both the Australian Competition and Consumer Commission (ACCC) and the Productivity Commission. The ACCC's primary role is in administering and ensuring compliance with competition law and policy. The Productivity Commission's focus is broad, covering a range of economic, social and environmental issues which impact on economic productivity.

It is important to have an oversight body with an exclusive focus on competition policy, independent from the compliance function. This body would oversee competition policy, consider the economic and efficiency implications of competition policy, advocate its advantages to inject some objectivity and clarity to often superficial debates, and ensure that competition policy continues to be relevant to a changing economy. Existing institutions might be able to provide the necessary oversight, or there could be a case to establish a separate body. In either scenario, the body would work closely with the ACCC, Productivity Commission and other relevant organisations to ensure there is no duplication or overlap.

The benefits of establishing such a body include: ensuring ongoing commitment to competition reform; providing independent and transparent assessment processes; and promoting public understanding of the rationale for and benefits of reforms.

## **Recommendations**

5. An independent national body should be tasked with the responsibility for monitoring progress in implementing reforms, assisted by a competition policy agreement, periodically identifying areas for competition reform, making recommendations on these areas to governments, and playing an advocacy role.

## **Sharing the benefits and locking-in reform**

### **Competition reforms will benefit the nation**

Competition is a key driver of productivity, innovation and economic growth, benefiting the nation as a whole. Governments have an important role to play by fostering competitive markets through removing regulatory impediments to competition in both the public and private sectors. Reforms to increase competition help to remove market distortions and allow finite resources to flow to the areas of highest return.

A competition reform agenda needs to be supported by an institutional structure that ensures jurisdictions are committed to the reform agenda and to ensure reform momentum is maintained. The institutional structure should be set out in an agreement between the Commonwealth and the States. It should also set out the incentive mechanisms, including any financial incentives that might be provided to ensure that the economic growth and revenue benefits from competition reforms are shared in a way that is proportionate with reform effort and costs.

Any system of financial incentives will need to be designed at the outset with a number of factors in mind. It needs to draw on the lessons from the NCP competition policy payments and more recent experience with facilitation and reward payment structures under the Council of Australian Governments (COAG) reforms. We would welcome further discussion with the Panel on design aspects including the need to:

- provide upfront funding to address implementation and transition costs, including any distributional impacts;
- adequately specify performance milestones while leaving flexibility to accommodate improved solutions where they become known;
- ensure the appropriate incentives are in place to fully implement reforms; and
- provide the necessary funding certainty for budgeting purposes.

### **Competition payments help share the benefits of reform**

Mismatches between the distribution of costs and benefits associated with competition reforms can create financial and political impediments to State governments unilaterally undertaking competition reforms, particularly given Australia's high level of vertical fiscal imbalance (VFI).

Under the NCP reforms, State, Territory and Local Government initiatives were projected to raise GDP by around \$19 billion a year (a 4.5 per cent boost to GDP), and Commonwealth Government initiatives were expected to increase GDP by \$4 billion a year (1 per cent of GDP).<sup>8</sup> Although State reforms were expected to account for more than 80 per cent of the projected increase in GDP, States were expected to receive only 34 per cent of the increased revenue.<sup>9</sup>

VFI means that the Commonwealth would receive the largest revenue benefit from the economic growth arising from competition-enhancing reforms (via the increase in tax revenue), though for many types of reform, the expense associated with undertaking reform is largely borne by State governments. Financial incentives could be used to contribute to the implementation costs of reform that are borne by the States, which are typically upfront while the benefits accrue over time. These costs can also include

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<sup>8</sup> Industry Commission, *The Growth and Revenue Implications of Hilmer and Related Reforms*, AGPS, Canberra, 1995.

<sup>9</sup> *Ibid.*

transition assistance for businesses and households that may be required for particular reforms. Financial incentives could also assist in securing national reform where the benefits of reform are not shared evenly between the States.

The NCP competition payments were underpinned by principles that set out how benefits from future competition reforms were to be shared and how incentives could ensure reforms continued to progress. Similar principles should be established to underpin any financial incentive payments in this second wave of competition reform. It is important that the institutional framework to implement reform, including financial incentive payments, should be designed so as to ensure jurisdictions retain flexibility in the implementation phase.

### **Competition payments can help to secure the benefits of reform**

Financial incentives and coordinated reform effort can also help to overcome the various barriers to reform which governments may face, such as strong vested interests or community scepticism on the benefits of change, and concerns about potential costs.<sup>10</sup> In some instances there are also disincentives for one jurisdiction implementing a reform ahead of another and there can be spillover benefits in coordinated action. Incentive payments can ensure that reforms that create spillover benefits are undertaken.<sup>11</sup>

In addition to providing a financial reward for reform progress, the NCP incentive payments also provided an accountability mechanism for governments by including provision for penalties (deductions or suspensions of competition payments), which discouraged States from backsiding on agreed reforms. The incentive to comply with agreed reforms was further strengthened by the prospect of being publicly criticised by an independent agency (the NCC) if the jurisdictions were assessed as non-compliant. A similar accountability mechanism could be implemented in the context of a new set of competition reforms, with reward payments calibrated to realised achievements, and not forecast activity.

### **Experience highlights the critical role of financial payments in reform success**

A significant lesson from the experience of the NCP is the critical role financial incentives ('competition payments') played in helping jurisdictions with the implementation costs associated with some of the significant and complex competition reforms, and maintaining reform momentum. The competition payments were implemented to recognise the unequal dispersion across jurisdictions of the costs and benefits of many of the NCP reforms.

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<sup>10</sup> Corden, S, *Australia's National Competition Policy: Possible Implications for Mexico*, OECD, 2009.

<sup>11</sup> CEDA, *Six myths of federal-state financial relations*, 2009, viewed on 16 May 2014 at [http://www.ceda.com.au/research-and-policy/research/2009/11/economy/six\\_myths\\_federal\\_state](http://www.ceda.com.au/research-and-policy/research/2009/11/economy/six_myths_federal_state).

The NCP was a “landmark achievement in nationally coordinated economic reform” which delivered significant economic and social benefits to the community.<sup>12</sup> The Productivity Commission’s 2005 review of the impact of the NCP found that it:

- contributed to the productivity surge that underpinned 13 years of continuous economic growth, and associated strong growth in household incomes;
- directly reduced the prices of goods and services such as electricity and milk;
- stimulated business innovation, customer responsiveness and choice; and
- helped meet some environmental goals, including the more efficient use of water.<sup>13</sup>

Before the NCP, Australian governments had pursued economic reforms largely unilaterally and therefore the reforms were narrower in scope.

Quantitative modelling had anticipated that major elements of the NCP could potentially generate an increase in GDP of 5.5 per cent a year over the longer term. More selective analysis, undertaken by the Productivity Commission in 2005, indicated that the NCP reforms had been an important contributor to productivity improvements and price changes in six key infrastructure sectors, generating an observed permanent increase in Australia’s GDP of 2.5 per cent (around \$20 billion).<sup>14</sup> This analysis excluded the ‘dynamic’ efficiency gains from more competitive markets. The NCP also contributed to fostering a more flexible, responsive and innovative business culture.

The NCC acknowledged the central role of competition payments in contributing to the success of the NCP:

“Using competition payments to leverage reform outcomes in areas of State and Territory responsibility has proven highly effective. … Reform would have been far slower and less comprehensive without competition payments. These payments (now at around \$800 million per year) may not be large relative to State and Territory budgets, but nonetheless represent a significant source of incremental funds. (sub. 71, p. 35).”<sup>15</sup>

The Productivity Commission noted that the success of the NCP was due to a number of factors:

- there was bipartisan consensus across all levels of government on the need for reform;
- governments reached a broad agreement on the priority reform areas;

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<sup>12</sup> Productivity Commission, *Review of National Competition Policy Reforms*, Report no. 33, Productivity Commission, Canberra, 2005.

<sup>13</sup> *Ibid*, p. xii.

<sup>14</sup> *Ibid*, p. xvii.

<sup>15</sup> *Ibid*, p. 152.

- there was a solid conceptual framework and information framework that guided policy changes; and
- the procedural and institutional mechanisms (including financial incentives) that were in place to implement reform.<sup>16</sup>

Further evidence of the benefits of financial incentives in achieving successful reform is demonstrated by Australia's experience with the Seamless National Economy National Agreement (SNE). The reform momentum was much higher for the deregulation reforms (Part 1) which were subject to reward payments, than the competition reforms (Part 2), for which no reward payments were made.<sup>17</sup> The COAG Reform Council's assessment of reform progress found that governments completed 21 of 26 reward reforms, compared with 10 of 19 non-reward reforms over the five year life of the agreement.<sup>18</sup>

### **Other lessons from the NCP reforms**

Governments can learn from not only the successes achieved through the NCP, but also from the challenges that arose, including:<sup>19</sup>

- Not all reforms were delivered and, in some cases, reforms did not achieve their underlying objectives. For example, electricity market reforms did not deliver a fully-effective national market and the legislation review program had mixed results. Not all reviews were completed and the recommendations from a number of key reviews (such as the review of pharmacy regulation) were not implemented.
- Experience with the NCP affirms the importance of clearly specifying reform commitments and priorities. For example, while the initial commitments for electricity and gas reforms were specific, those for water and road transport were more general. Considerable delays in the reforms to water and road transport arose because of the need to clarify the nature of the reforms, to resolve differences between jurisdictions in their approaches to implementation, and to put in place the appropriate institutional arrangements. This highlights the importance of specifying reform commitments in advance, effectively prioritising the reform task, monitoring progress and allowing for modification when challenges arise.

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<sup>16</sup> *Ibid*, p. xxiii.

<sup>17</sup> COAG Reform Council, *National Partnership Agreement to Deliver a Seamless National Economy: Report on Performance 2008-09*, Report to the Council of Australian Governments, Sydney, 2009.

<sup>18</sup> COAG Reform Council, *Seamless National Economy: Final report on performance*, Report to the Council of Australian Governments, Sydney, 2013.

<sup>19</sup> Productivity Commission, *Review of National Competition Policy Reforms*, Report No. 33, Productivity Commission, Canberra, 2005.

- While the community as a whole has benefited from the NCP, the adjustment burden and costs did not always fall evenly on some parts of the community, such as regional communities and local governments.
- The implementation of the legislative review process also posed some challenges. The Productivity Commission reported that the independence of some legislative reviews was questionable, and the conduct of reviews and basis for the outcomes were not always transparent.

### **The appropriate institutional structures need to be in place to support financial incentives**

The incentive mechanism should be institutionalised through an agreement between the Commonwealth and the States which sets out the underlying principles that underpin financial incentive payments, and the governance mechanisms (including the accountability framework).

The Productivity Commission could be tasked with determining the growth and revenue impacts of any future reform package to inform an agreement on payments from the Commonwealth to the States and Territories (the States), taking into account adjustment and distributional issues.

There would also be benefit in tasking the Productivity Commission to prepare a five-yearly report on Australia's past productivity performance, factors impeding productivity growth, and the future direction and priorities for productivity-enhancing reform. Such a report would highlight potential reforms to boost competition in Australia. It would maintain reform momentum, and make the case for continuous reform to drive productivity growth and improvements in living standards.

## **Recommendations**

6. The provision of financial incentives from the Commonwealth to the States would help lock-in reforms and share the economic growth and revenue benefits (which would largely be captured by Commonwealth tax bases) in a way that is proportionate with reform effort and outcomes.
7. The incentive mechanisms should be institutionalised through an agreement between the Commonwealth and the States.
8. Principles should be established to underpin any financial incentive payments. The principles should set out how the benefits from future competition reforms should be shared, acknowledging implementation costs and distributional impacts and be calibrated to realised achievements, and not forecast activity.
9. The Productivity Commission should be tasked with determining the growth and revenue impacts of any future reform package to inform an agreement on financial incentives, taking into account adjustment and distributional issues.
10. An accountability mechanism should be introduced alongside the financial incentive payments. This could take the form of public reporting by the independent body on jurisdictions' reform progress, highlighting where inadequate progress has been made.
11. The design of the institutional framework to implement reform, including financial incentive payments, should be informed by the experience of past rounds of national reform to ensure new arrangements are as effective as possible. The arrangements should be designed so as to ensure jurisdictions retain flexibility in the implementation phase.
12. The Productivity Commission needs to be tasked to prepare a five-yearly report on Australia's productivity performance, factors impeding productivity growth (including impediments to competition), and the future direction for productivity-enhancing reform.

## Commonwealth and State regulatory impediments to competition

There are a number of areas in which regulatory impediments to competition exist within different industries. These impediments can create barriers to entry into markets, limit the range of activities in which market participants can engage, and create restraints on the type of goods and services that can be offered (for example, through product standards).

Regulatory impediments to competition can have a number of negative effects. They can:

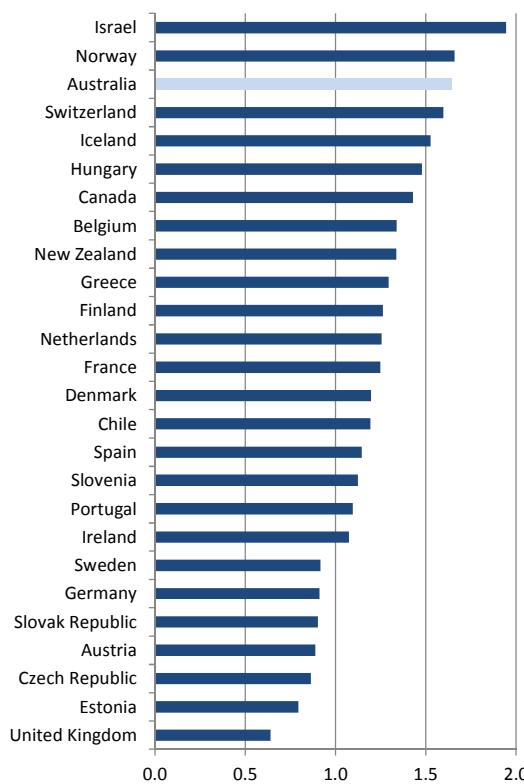
- reduce the incentives for organisations to reduce costs and introduce product and process improvements;
- create concentrated markets and allow market participants to earn economic rents (which is inefficient);
- reduce the incentives for organisations to innovate;
- increase costs for consumers;
- decrease choice for consumers; and
- lead to a reduction in technical and allocative efficiency, which can reduce productivity growth.

According to the Organisation for Economic Cooperation and Development (OECD), product market regulation in Australia increased over the five years to 2013 across a range of areas including increased:

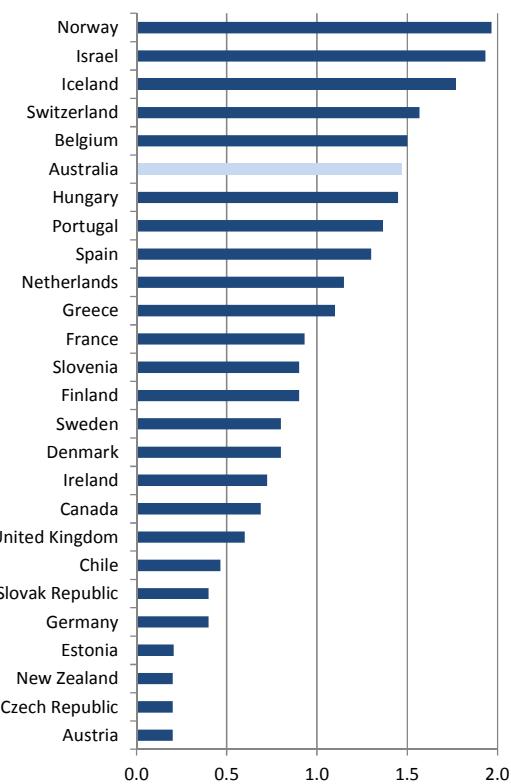
- regulatory protection to incumbents;
- legal barriers to entry;
- regulatory barriers to entrepreneurship; and
- complexity of regulatory procedures.

Moreover, when compared to other OECD countries, product market regulation in Australia is relatively high. This is particularly relevant for regulations that protect incumbents and create barriers to entry as these types of regulations restrict competition (Chart 1 and Chart 2).

**Chart 1: Protection of incumbents, OECD index, 2013<sup>20</sup>**



**Chart 2: Legal barriers to entry, OECD index, 2013<sup>21</sup>**



There are also areas of regulatory overlap, where more than one level of government imposes regulations on a sector that affect competition. Situations where regulatory overlaps exist highlight the broader question of the roles and responsibilities of the different levels of Government (this is being considered as part of the White Paper on Reform of the Federation).

Regulations that have the effect of limiting competition are often put in place to achieve other public policy objectives, such as consumer protection. Issues arise, however, when the costs of these regulations (in terms of limiting competition) outweigh the public policy benefits. When this occurs, consideration needs to be given to alternative regulatory and policy instruments that could be used to achieve the same public policy outcome. One challenge is to differentiate legitimate consumer protection concerns from what can simply be protecting incumbents from new entrants.

Impediments to competition can also arise from assistance provided by governments to industry or particular regions, either in the form of direct grants, tariffs or tax

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<sup>20</sup> Koske, I, Wanner, I, Bitetti, R and Barbiero, O, "The 2013 update of the OECD product market regulation indicators: policy insights for OECD and non-OECD countries", OECD Economics Department Working Papers, 2014.

<sup>21</sup> *Ibid.*

concessions.<sup>22</sup> In some cases industry assistance and assistance to particular regions can play a role in correcting market failure, and in these cases if the assistance is well targeted and well-designed it can provide wider benefits to the community. Where governments provide assistance to particular regions or industries, it is preferable that this is done using transparent and targeted means.

However, if industry assistance is provided when there is no genuine market failure it can reduce competition by propping up less productive firms. This can have a negative effect on other industries, taxpayers and consumers, and contribute to slower productivity growth. As such, the Review Panel emphasise that a future competition reform process should consider industry assistance to ensure that its design principles do not impede competition and contestability, but generate a net social benefit.

Unwarranted regulatory impediments to competition exist in a number of sectors in Australia, some of which arise from Commonwealth regulations, some from State regulations, and some impediments are a result of either regulatory differences between jurisdictions or regulatory overlaps.

One particular area of interest is price regulation. Historically, price regulation has been used by governments to protect consumers where there is inadequate competition. However, in many cases, following periods of reform, governments have concluded that the largest consumer benefit comes from active competition. One such example is the retail electricity market in NSW, where, on the recommendation of the Independent Pricing and Regulatory Tribunal, the NSW Government has committed to deregulate prices from 1 July 2014. The Australian Energy Market Commission (AEMC) found that in NSW the regulated price for electricity is not the best price, with substantial discounts available to consumers on market contracts.<sup>23</sup>

While Governments can establish frameworks and access regimes to encourage competition in markets, the private sector will only participate if there is a cost-reflective price regime in place which enables the private participant to earn a sufficient return on investment. As such, the Competition Policy Review Panel should consider the extent to which price regulation across a range of sectors encourages or inhibits competition. Consideration should also be given to arrangements that would assist customers in the transition to market-based pricing, for example through staged implementation of any changes.

Some regulatory impediments to competition are a result of regulations that are imposed by multiple levels of government, which can in some cases result in regulatory overlaps and duplications. In these areas, it will be necessary for the States and the

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<sup>22</sup> According to the Productivity Commission, the Australian Governments paid \$10.5 billion in industry assistance in 2011-12 including budgetary assistance and net tariff assistance. Productivity Commission, *Trade and Assistance Review 2011-12*, Annual Report Series, Productivity Commission, Canberra, 2013.

<sup>23</sup> AEMC, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales*, Report, Sydney, 2013, p. ii.

Commonwealth to work together to maximise the potential gains from increased competition.

For areas where there is regulatory overlap it is important to consider not only whether there is a case to streamline regulations to reduce duplication, but also whether it is necessary to have regulators across different levels of Government.

COAG is currently working with the States to reduce regulatory overlaps and the overall regulatory burden, focussing initially on regulations that affect small businesses, and the higher education, manufacturing and early childhood education sectors. As part of this the NSW Government:

- is undertaking targeted reviews of end-to-end regulations for small businesses across five industry sectors: cafés and restaurants, housing construction, clothing retail, road freight and print manufacturing; and
- has signed a MOU with the Commonwealth to streamline environmental assessments by creating a one-stop-shop and imposing a 12-month time limit on approvals.

The success of any one-stop-shop arrangement rests on aligning the different legislative bases of the Commonwealth and State environment regulation and approvals. The NSW Government is well advanced on a new biodiversity framework that aims to meet both regimes. Achieving a durable reduction in overlap and divergent regulation may well take a long term effort. Competition policy can add impetus to this work by addressing any restrictions to competition presented by regulation and regulatory overlap (including environmental regulation).

It is important to note that there are some instances where national reform efforts have been unsuccessful due to lack of agreement between jurisdictions, or where reform progress has been very slow. There are a number of examples where this has occurred with the SNE reforms, including reforms to:<sup>24</sup>

- create nationally harmonised occupational health and safety (OH&S) legislation, which was not successful because jurisdictions adopted different positions on the national law;
- establish a nationally consistent and principles-based approach to applying corporate fault to directors' (directors' liability), which has not yet been introduced in three jurisdictions, though two jurisdictions are currently drafting the legislation and will introduce it to Parliament later in 2014 and the remaining jurisdiction has introduced but not passed the legislation; and
- create a national regulation for the legal profession, which was not successful as only two jurisdictions, NSW and Victoria, committed to advancing the reform. In

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<sup>24</sup> COAG Reform Council, *Seamless National Economy: Final report on performance*, Report to the Council of Australian Governments, COAG Reform Council, Sydney, 2013.

December 2013, the NSW and Victorian Governments signed a bilateral Intergovernmental Agreement on a Legal Profession Uniform Framework to harmonise legal professional regulations.

This demonstrates that a well-established governance framework and effective incentive mechanism (as discussed above) is critically important in the areas where the Commonwealth and States need to work together to achieve improvements in competition.

### **Recommendations**

13. The Review Panel should emphasise that a future competition reform process should consider industry assistance to ensure that its design principles do not impede competition and contestability, but generate a net social benefit.
14. The Review Panel should consider the extent to which price regulation across a range of sectors encourages or inhibits competition.
15. The Review Panel should identify areas where regulatory overlaps between jurisdictions can be reduced. The Federation White Paper will also provide an opportunity to address better ways of streamlining joint Federal/State roles.
16. For areas where there is regulatory overlap, it is important to consider whether regulations should be streamlined to reduce duplication, whether it is necessary to have regulators across different levels of government, and consider which level is appropriate.

## New challenges and opportunities for competition

### Improving government service delivery

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#### Improving competition in public services through strategic commissioning

Increased competition and innovation in public service provision can result in significant benefits, and The NSW Government believes that strategic commissioning is the most effective way to realise those benefits.

Strategic commissioning means working out what it is that the government wants provided and designing the best system to deliver those services.

The benefits of strategic commissioning can include:

- increased choice and improved outcomes for customers and citizens;
- greater transparency in decision-making;
- better value-for-money for taxpayers, more sustainable government finances and reduced debt, and delivery of major infrastructure on time and within budget;
- productivity improvements;
- a genuine openness to innovation and diversity in the Australian economy, including development of new areas of expertise and innovation; and
- more flexibility and adaptability in the provision of public services, which could empower individuals through providing them with increased choice.

Strategic commissioning is not code for outsourcing. The NSW Government supports increased competition in the provision of public services, though a one-size-fits-all approach is not appropriate. There are many good examples in Australia and overseas where outsourcing of public services has delivered improved outcomes in terms of improved services for the public and budgetary savings. Generally these benefits have been the result of increased competition in the outsourcing process as opposed to outsourcing itself. However, there are also many examples where outsourcing public services has merely transferred a public sector monopoly to the private sector, resulting in increased costs, little or no service improvement and a need for extensive new regulation.

In some cases the most suitable provider will be the private sector or non-government organisations (NGOs), while in others it will be a public sector provider. A truly contestable system provides the competitive tension that ensures the provider is always incentivised to provide the best service for the customer cost effectively.

In some areas, impediments exist that make it challenging for the private sector to effectively compete with the public sector, despite competitive neutrality requirements. There may be scope to increase contestability in public service markets, including for individual components of the service delivery chain, if community service obligations (CSOs) were transparent, explicitly priced and directly funded by the government.

Strategic commissioning can play a key role in reforming public service markets and opening them up to competition.

The greatest scope for increased competition in the public sector is in the provision of social and community services, including in health, education and justice. As noted above, this needs to be done carefully. Where services continue to be provided by the public sector, service provision can still be improved through benchmarking service performance against potential competitors from non-government providers (either the full service or one of the service components).

A well-considered State and Commonwealth strategic commissioning framework across all these areas of public service provision – utilities, transport and social and community services – will help ensure the best possible outcomes. The framework should apply to all public services, but recognising that the most appropriate service delivery model will depend on the nature of the service being commissioned.

### **Recent examples of strategic commissioning**

Reforms involving strategic commissioning approaches to service delivery are already underway in a range of jurisdictions, both in Australia and internationally. Recent examples of strategic commissioning being undertaken in NSW include:

- **Northern Beaches Hospital PPP:** The NSW Government is currently evaluating bids from two private hospital operators in response to its formal Request for Proposal to design, construct, operate (on a fully outsourced basis) and maintain a hospital on Sydney's northern beaches. In contrast to the usual co-location model, this involves the innovative purchasing of services by the Government from the private sector. In partnering with the private sector, a private Hospital Operator will be responsible for all aspects of design and construction of the hospital and the provision of clinical services, clinical support services and facility related services for public patients, under a long term contract with the NSW government and as part of the clinical service delivery network of the Northern Sydney Local Health District. This model provides maximum opportunity to add value through innovation and whole of system integrated delivery, with significant benefits to the community.
- **Social benefit bonds:** The NSW Government in partnership with the private and community sectors has developed two social benefit bonds (SBBs) to deliver prevention and early intervention programs. The Benevolent Society SBB will involve intensive work with up to 400 families and their children in the Resilient Families Service, and the Newpin SBB with UnitingCare Burnside will provide support to over 700 families to improve parenting styles, behaviour and practices. These programs are initially funded by private investors who receive a return on their investment if agreed social outcomes are achieved, including preventing the need for acute public services in the future and providing savings to Government.
- **Road maintenance in Sydney:** Historically road maintenance in most parts of Sydney has been delivered by the public sector and only around 10 per cent of

road maintenance in Sydney was previously delivered by the private sector. In late 2013 two contracts for road maintenance in the south and west of Sydney were awarded, which significantly increases the level of private sector involvement in this market. These contracts, worth \$2 billion over 10 years, use a payment-by-outcome approach based (in part) on road quality and customer service. The savings which will be achieved through the new contracts are estimated to be between 5 per cent and 10 per cent.

- **National Disability Insurance Scheme (NDIS):** With the introduction of the NDIS over the next five years, disability service providers will move from being contracted by government to being registered providers with the National Disability Insurance Agency (NDIA). Funding for disability support will follow individual service users rather than service providers, enabling individuals to choose the providers from whom they wish to receive services. Individuals electing to receive direct payments for purchasing their support (subject to a risk assessment) will not be restricted to choosing providers registered with the NDIA.
- **Ability Links:** The new *Ability Links NSW* project is seeking to increase support for people with a disability through the Department of Family and Community Services improving the coordination of information on service providers. The increased availability of information has driven competition for services as people look for mainstream services which offer specialist care.
- **Sydney Ferries:** In 2012, Sydney Ferries shifted to a franchise model for the operation of ferry services. Under this model the franchisee, Harbour City Ferries, is the operator of Sydney Ferries services. The NSW Government has control of fares, routes and required service levels, and it owns Sydney Ferries' existing vessels, and the Balmain Shipyard. The franchise contract includes staff and safety obligations.
- **Cleaning for rail services:** Transport Cleaning Services was established in September 2012, as a subsidiary of RailCorp, and in February 2013, it began operations to deliver the services previously performed by RailCorp. Transport Cleaning Services has engaged Transfield Services as the managing contractor to drive the improvements through the day-to-day operational management of frontline cleaning staff.
- **Vocational education and training (VET):** Significant changes are being made to increase contestability in the VET market in NSW as part of the *Smart and Skilled* reforms. These reforms include introducing a demand-driven system through individual student entitlements to government subsidised training for identified skills (from 1 January 2015), allowing the funds to follow the student to their choice of approved training organisation and increasing the contestability of government subsidies for training. The reforms also change TAFE governance structures, increasing competitive neutrality by separating the purchaser and provider roles and ensuring TAFE Institutes compete on a more neutral basis.

- **Non-emergency patient transport (NEPT):** The NSW Government has committed to reforming NEPT to introduce more contestability through restructuring NEPT services to a fee-for-service and purchaser-provider model, and separating emergency and non-emergency transport providers. The next stage of this reform process is to market test internal service provision in one Local Health District. A Request for Tender for the provision of NEPT services has been issued for South East Sydney Local Health District as a pilot for the wider market testing for service.
- **Health services provided by NGOs:** NSW Health has also commenced a broad suite of reforms around how it purchases services from NGOs, moving away from grants funding towards a more contestable model. The \$150 million Grants Management Investment Program (GMIP) will be phased out and replaced with a contestable approach to purchasing services. The GMIP provided funding to around 300 NGOs in NSW to deliver health and community services in the areas of Aboriginal health, drug and alcohol, mental health, HIV/AIDS, oral health, women's health and chronic illness support. An incremental approach to reform will be critical to ensure NGOs have time to develop the necessary skills to operate in a contestable funding environment.

#### **Factors to consider when introducing a strategic commissioning approach to service delivery**

NSW has identified the following lessons on how introducing contestability into service delivery can deliver the greatest benefits:

- Governments need to establish an effective reform process, which involves clearly communicating reform objectives to both service providers and the public, and establishing clear roles and accountabilities in relation to commissioning functions. In undertaking reforms, governments should maximise policy stability, otherwise the market will build risk premiums into prices and quality providers will be deterred from investing, thereby reducing the benefits of competition.
- Governments need to carefully consider the most appropriate delivery model for a given service. This will depend on the nature of the service and the characteristics of the market, including the market depth and the capabilities of market participants. In some cases it might be necessary for governments to undertake market development before opening up the service to competition.
- The benefits from involving non-government service providers are larger where governments actively engage with current and potential service providers before commencing a reform, with the view to understanding their capabilities and obtaining their suggestions on how best to deliver services.
- An effective monitoring regime should be established, which includes clear performance and service benchmarks, creates a credible threat to underperforming providers of being replaced so that service levels are maintained, and a process to engage new providers promptly when needed.

- Throughout the monitoring process, governments should maintain a focus on results by regularly asking if outcomes and the needs of service users are being met. For instance, the monitoring regime can help ensure competitive processes do not undermine collaboration between service providers.
- Adequate and comparable data on service providers is important for monitoring service providers, and for reviewing existing government services. Such data is important to underpin effective performance and contract management with non-government providers and to support service evaluations.
- There are more significant benefits from competition and innovation when governments take a less prescriptive approach to service delivery reform. This can allow greater adaptability and flexibility that takes account of technological change without constant rule and regulation changes. Instead, the focus should be on specifying desired outcomes and ensuring space for innovation.
- Where reform involves contracting with non-government service providers, contracts should be structured to ensure competitive tension is maintained. For example, contract durations should be short enough to maintain competitive pressures on incumbent service providers, but of sufficient length to ensure service providers obtain a satisfactory return.
- Governments should take active steps to develop and oversee markets, including building the capabilities of providers over time so that there will be a strong field of competitors in the future and developing sustainable markets where they do not already exist. This is important to avoid having an inappropriate level of concentration in a market (for example by replacing a public with a private monopoly) and to avoid an unintended loss of service providers. To ensure this does not occur, it will be important that charitable and community-managed organisations develop robust governance and viable business models which allow these organisations to be successful in a more contestable funding environment.
- Governments need to ensure that there is an adequate spread of services and funding for infrastructure to support service delivery in new or more remote locations, which may be unprofitable for non-government providers. To achieve this, it is critically important that CSOs are explicit, and there is competitive neutrality between government and non-government providers.
- Governments should ensure that public servants have well developed commissioning, contracting and market design skills.
- Service providers need to be prevented from ‘gaming’ the system. For example, contract payments should not encourage ‘cherry picking’ easy clients (by paying for results that would have happened anyway) and ‘parking’ challenging cases.
- In some instances, regulations may restrict the scope to engage non-government providers (for example statutory limitations that mean only government providers can offer a service). In other cases, industrial relations

issues may need to be managed, particularly where there are different employment conditions applying to government and non-government employees.

## Recommendations

17. Governments could consider developing their own strategic commissioning frameworks to apply across all areas of public service provision including utilities, transport and social and community services. Governments could share experiences and cooperate on strategic commissioning implementation as appropriate.

## Technology and product innovation

Australia is regarded as a ‘fast follower’ in using and adopting new technology. This rapid diffusion of new digital technologies presents consumers with greater choice as new competitors offer innovative products and services at lower prices. New business models, often operating in parallel to traditional regulated markets, seek to meet consumer needs in innovative ways, for example by offering consumption based on product sharing, rather than ownership.

### New markets open up opportunities for increased competition

New markets open up opportunities for young agile firms to compete and expand; such firms play a potentially important role in job creation. The strongest job creators in an economy tend to be young, high growth firms. An OECD study published in 2013 shows that job creation is concentrated amongst young firms. While young firms (less than five years old) account for only about 21 per cent of employment, they generate about half of all new jobs.<sup>25</sup>

Other studies undertaken across OECD countries have reached similar conclusions: one widely cited study from the United States found that these firms comprised only 4 per cent of all businesses, but generated 70 per cent of new jobs.<sup>26</sup>

It is important to differentiate between young firms and small firms. Many small businesses are not young firms; they are well established firms that remain small. Competition is enhanced if government policy and regulations:

- act to promote flexibility in markets;
- allow new firms to enter the market;

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<sup>25</sup> OECD, *Sources of growth and the crisis*, in *OECD science, technology and industry scoreboard 2013: Innovation for Growth*, 2013.

<sup>26</sup> A comprehensive survey of these studies is contained in Henrekson M and Johnson D, “Gazelles as job creators: a survey and interpretation of the evidence”, *Small Business Economics*, Vol. 35, 2010, pp. 227-244.

Birch, D L, Haggerty, A and Parsons, W, *Who's creating jobs?*, Cognetics Inc, Boston, 1993.

- do not impede small businesses from growing; and
- allow businesses to seamlessly exit markets (for example through effective bankruptcy laws).

### **Opportunities and challenges for governments**

These developments recast the landscape for competition policy. Governments can influence the potential benefits derived from new products and markets enabled by digital technologies.

In reviewing existing regulatory arrangements, governments need to consider how to best serve the public interest. Regulations may need to take into account consumer welfare, including safety and quality, but these considerations need to be balanced against the potentially significant benefits to consumers from greater innovation and competition. The key challenge is striking the right balance.

Appropriate regulatory responses which best serve the public interest are likely to involve adaption, rather than prohibition.<sup>27</sup> Pertinent issues governments will need to address include:

- where new products and services do not conform to existing market regulations, whether those regulations actually serve the public interest; and
- the way in which competition laws and existing regulations can be adapted to market developments in a way that best serves the public interest, given the potential benefits from new products and markets.

One area where these issues are particularly pertinent is in new markets enabled by digital technologies which offer consumption based on product sharing rather than ownership. While many policies drafted when ownership was the main method of consumption are silent about sharing, there is scope to realise the full potential of these new markets. This is a regulatory challenge for governments, with the World Economic Forum recognising that the potential benefits arising from new markets warrant a ‘parallel and complementary set of rules’.<sup>28</sup>

New digital technologies also present opportunities for innovation within government. Digital technologies can be used by governments to support their regulatory functions. For example, the use of smart meters in measuring electricity consumption throughout the day has a number of benefits which support greater efficiency in electricity supply and allows for cost-reflective pricing. Digital technologies are also being applied to traffic management including for tolling and parking. For example ‘smart’ parking meters can support greater efficiency in the allocation and pricing of parking spaces by collecting data on parking occupancy and reporting back to drivers’ mobile devices.

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<sup>27</sup> The Economist, *The sharing economy: Remove the roadblocks*, 26 April 2014.

<sup>28</sup> World Economic Forum, *Young global leaders circular economy innovation and new business models dialogue: Young global leaders sharing economy position paper*, 2013.

In addition to the benefits that consumers and government may derive from new technologies, governments will need to consider whether technology and product innovation has given rise to any new regulatory challenges. For example, the Panel could consider whether technological and product developments have affected the ability of existing laws and regulations to address:

- intellectual property right issues; and
- any competition issues that might arise from internet-based services, such as comparator websites that present information to consumers to compare competitive offerings in a market but often only represent selected businesses.

That said governments need to keep in mind how regulation design and regulatory decisions are likely to affect innovative activity in the economy in the future and ensure that regulations do not stifle competition in a way that ultimately is to the detriment of consumers. It is essential that the approach to regulation and enforcement is outcomes-based rather than prescriptive. This ensures that the regulatory intervention is flexible and reduces any adverse effects on competition.

### **Technology and regulation: recent experience**

Governments in Australia and overseas are starting to deal with regulatory issues posed by new business models and markets enabled by digital technologies. The examples below are focussed on developments in the ‘sharing economy’ and the response of governments and regulators.

In the accommodation market, Airbnb has emerged as the largest international venture offering house-sharing arrangements for short term accommodation. Jurisdictions around the world have started to address the rising popularity of short-term rentals by opening up home sharing rights mostly on a limited basis, seeking to balance the availability of residential accommodation in cities with the benefits of short-term accommodation:

- New laws in France were introduced in March 2014 to allow home owners to rent out their primary residence on a short-term basis.<sup>29</sup>
- Amsterdam has recently permitted short-term rentals on a limited basis, allowing principal occupiers to rent out their property for a cumulative maximum of 4 months a year (otherwise they are subject to hotel taxes).<sup>30</sup>
- San Francisco has introduced limited rights for short term rentals, allowing hosts to rent-out their property on a short-term basis, but requiring them to live in their

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<sup>29</sup> Hantman, D, ‘A major step forward in Paris and France — Une avancée majeure en France’, Airbnb blog, 26 March 2014, viewed 7 May 2014 at <http://publicpolicy.airbnb.com/major-step-forward-paris-france/>

<sup>30</sup> Collaborative Consumption, ‘Airbnb is to stay in Amsterdam’, viewed 7 May 2014 at <http://www.collaborativeconsumption.com/2014/02/04/airbnb-is-to-stay-in-amsterdam/>.

property at least three-quarters of the time, register with the city and pay the 14 per cent hotel tax.

- In February 2014, the British government announced a review of the regulatory restrictions on short-term rentals in London, with a view to potentially easing the regulatory burden. Current planning regulations in London restrict residential property owners from renting out residences for less than three months because it would not be ‘residential use’ of a property.<sup>31</sup>
- A recent Supreme Court decision in Victoria made clear that existing building regulations cannot restrict short-term rentals in residential apartment buildings.<sup>32</sup>

Shared car transport services are also quickly growing in Australia through car-sharing and ride-sharing services. Car-sharing has become a well-established transport alternative in Australia, with a range of companies that offer car rental by the hour in Sydney, Melbourne, Adelaide and Brisbane, and a number of websites that facilitate peer-to-peer car sharing.<sup>33</sup>

The emergence of car-sharing has attracted minimal regulatory response. In fact, local governments in NSW actively support car-sharing companies by dedicating car spaces for the exclusive use of car-share vehicles, particularly around inner Sydney. Most local councils around inner Sydney provide dedicated parking spaces, and the use of these spaces is regulated by agreements between councils and car-share providers.

By contrast, regulatory positions by governments on ride-sharing services have been mixed. Non-market ride sharing services provided through websites that facilitate car-pooling have attracted minimal regulatory response. However, governments across a number of jurisdictions have begun to consider their regulatory responses to companies offering ride-sharing services, including Uber (which operates in Europe and the United States, and has recently introduced services in Melbourne, Sydney and Brisbane), Lyft and SideCar. In many jurisdictions the issue remains subject to public debate:

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<sup>31</sup> Goodall, M, ‘Short-term lets in Greater London’, *Martin Goodall’s Planning Law Blog*, 25 February 2014, viewed 7 May 2014 at <http://planninglawblog.blogspot.com.au/2014/02/short-term-lets-in-greater-london.html>.

<sup>32</sup> That is, the Building Code of Australia should not restrict owners in Class 2 buildings from renting out their properties on a short-term basis. Strata Community Australia, ‘Short-term leasing’, viewed 7 May 2014 at <http://www.stratacommunity.org.au/featured-articles/short-term-leasing>.

<sup>33</sup> Companies that offer car sharing services require drivers to become members, often for an annual fee, and then members hire cars for short periods of time and pay an hourly rate. Car sharing companies have agreements in place with local councils to have a permanent car space allocated to cars in the fleet. Peer-to-peer car sharing allows car owners to convert their personal vehicles into share cars that can be rented to other drivers on a short-term basis. The payment structure is similar to rental based car sharing services, but the rates tend to be lower. Technology facilitates both types of car sharing: members make bookings online and cars are installed with security devices that provide members with access to the car without keys.

- Transport for London has been allowing ride-sharing services under current regulatory arrangements and is currently considering its final regulatory position on ride-sharing.
- The legality of ride-sharing under existing transport regulations has been subject to court proceedings in Berlin, where ride-sharing has been temporarily banned following a court injunction, and Brussels, where a court has ruled ride-sharing services illegal. The French government has conducted an inquiry into ride-sharing, although the regulator has not yet announced its position.
- In the United States, the rules have been subject to significant public debate in a range of cities including Dallas and Boston. In Seattle new regulations designed for ride-sharing services, including caps on vehicle numbers, are being reviewed following public opposition. California has adapted transport regulations to ride-sharing services by creating a new category of ‘transportation network companies’ which require driver training, background checks and insurance.
- Transport for NSW stated that the UberX service does not comply with the current NSW *Passenger Transport Act 1990*. The NSW Government has, however, acknowledged that it needs to consider how it adapts to new opportunities in the market and is considering its position in response to ride-sharing activities to ensure it considers the benefits to consumers and the impact on the industry.<sup>34</sup>

More generally, it is important to recognise that while regulatory challenges arising from new technologies are becoming increasingly pressing, governments should also not lose sight of the need to remove existing regulatory impediments, as this is likely to have the largest impact on Australia’s competitiveness.

### **Recommendations**

18. The Review Panel should consider how jurisdictions and competition frameworks can best anticipate and respond to digital technologies and product innovation – recognising that these developments can bring both opportunities to enhance competition and policy challenges for existing laws and regulations.

### **Further information and contacts**

For further Information or clarification on issues raised in the submission, please contact the NSW Treasury’s Economic Policy Division on 02 9228 5893.

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<sup>34</sup> Grubb, B, ‘Victoria government issues \$1700 fines to Uber ride-sharing drivers as media gaffe surfaces’, *Sydney Morning Herald*, 8 May 2014, viewed 9 May 2014 at <http://www.smh.com.au/digital-life/smartphone-apps/victoria-government-issues-1700-fines-to-uber-ridesharing-drivers-as-media-gaffe-surfaces-20140508-zr6yp.html>