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Deregulation and National Competition Policy and its Effect on Rural and Regional Areas

by

Stewart Smith

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EXECUTIVE SUMMARY

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National Competition Policy (NCP) is an element of micro-economic reform that has had an impact on all sectors of the economy and community. This Paper briefly traces the history of deregulation in Australia and the development of national competition policy. Reviews of NCP by the Productivity Commission and the Australian Senate are presented. A case study of the deregulation of the dairy farming industry is presented as an example of the effects of deregulation and the introduction of national competition policy.

In 1992, the Council of Australian Governments commissioned Professor Fred Hilmer to undertake an "Independent Committee of Inquiry into National Competition Policy". The subsequent report, known as the Hilmer Report, was released in August 1993. Acting on the Hilmer Report's recommendations, a number of reforms were drawn together in 1995 to form a package, agreed upon by all Australian Governments, and called National Competition Policy (pages 1- 4).

A review of NCP by the Productivity Commission concluded that NCP is just one element of micro-economic reform which is changing the social and economic structure of rural and regional Australia. Across NSW, NCP reforms are predicted by the Productivity Commission to increase gross regional product by 2.6 percent and employment by 0.1 percent. However, employment decreases are expected from NCP reforms in all NSW regions bar the Hunter – Sydney – Illawarra corridor and the Far West (pages 8-16).

The Senate Select Committee on the Socio-economic Consequences of the NCP found that the cumulative effects of changing technology, micro-economic reform and the globalisation of the economy were creating significant social pressures. NCP could not be isolated and 'blamed' for the problems facing rural and regional Australia (pages16 – 18). However the Senate Committee did conclude that the failure to properly apply the 'public interest test' of NCP is at the heart of its problems in rural areas (page 18-20).

The NSW dairy industry is presented as a case study on the effects of deregulation and the implementation of NCP reforms. The dairy industry has moved from being in an intensively regulated environment to one of deregulation, and is currently in a state of adjustment. Deregulation has led to a severe drop in dairy farm incomes and negative impacts on both industry participants and their surrounding communities (pages 22-33).

It is evident throughout this Paper that national competition policy, and micro-economic reform more generally, have created both winners and losers. One of the major problems is that, whilst the benefits of NCP are generally longer-term and spread more widely amongst the community, the costs of change are often concentrated in a particular area and borne immediately. Ultimately, how society compensates and supports those affected by NCP reforms is a key issue yet to be satisfactorily resolved.

1.0 INTRODUCTION

National Competition Policy is an element of micro-economic reform that has had an impact on all sectors of the economy and community. This Paper briefly traces the history of deregulation in Australia and the development of national competition policy. There have been several important reviews of national competition policy, most notably by the Productivity Commission and the Senate Select Committee on the Socio-economic consequences of national competition policy. These reviews and other commentator critiques are summarised in this paper. Finally, a case study of the deregulation of the dairy farming industry is presented as an example of the effects of deregulation and the introduction of national competition policy.

2.0 THE HISTORY OF DEREGULATION AND COMPETITION IN AUSTRALIA

The first national law dealing with restrictive business practice was the Commonwealth *Australian Industries Preservation Act 1906*. The Act prohibited monopolisation and combinations which restrained trade or commerce or destroyed or injured Australian industries by unfair competition. However, the effect of the Act was limited by a restrictive interpretation of the Commonwealth's powers in 1910, and the Act fell into general disuse. The Commonwealth made unsuccessful attempts to overcome the limitations of constitutional interpretation through a series of referenda in the first half of the century.[1]

During the 1950s and 1960s there was growing disquiet with the growing cartelisation and concentration of Australian industry. In 1961, there were over 600 trade associations in Australia, of which an estimated 58-66 percent operated restrictive trade practices. In 1962, the Commonwealth Attorney-General proposed a Restrictive Trade Practices Act, and this was ultimately enacted in 1965. The Act was relatively weak, requiring registration of certain agreements, with the possible dissallowance of those agreements if contrary to the public interest. In 1971 the High Court held the 1965 Act invalid on constitutional grounds, but provided a new interpretation of the Commonwealth's constitutional powers which permitted a greater involvement by the Commonwealth in the regulation of business conduct.[2]

The Parliament enacted replacement legislation, but the election of a new Government in 1972 saw a new approach to competition law, based on prohibition. The current *Trade Practices Act* became law in 1974, and prohibition of anti-competitive arrangements and judicial enforcement have remained the basic approach of competition law in Australia.

In regards to wider competition policy reforms, during the 1980s trade policy reform substantially increased competition in the domestic economy. The average level of effective

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1 Commonwealth of Australia, *National Competition Policy. Report by the Independent Committee of Inquiry*, August 1993. Referenda were held in 1913, 1919, 1929, and 1944.

2 Commonwealth of Australia, *National Competition Policy. Report by the Independent Committee of Inquiry*, August 1993, at 9.

assistance to manufacturing was reduced from 25 percent to 15 percent of the value of manufacturing output between 1981-82 and 1991-92. Reductions in import barriers exposed many industries to the rigours of international competition, providing increased incentives to improve product quality, costs and innovation.[3]

It was during the early 1990s that the argument supporting the development of a national competition policy found greater favour, and rested on several considerations. These included:

- The pro-competitive reforms implemented had largely progressed on a sector by sector basis, without the basis of a broader policy framework or process;
- Awareness that Australia was for most purposes a single national market. The economic significance of State and Territory boundaries were diminishing rapidly;
- The increasing national orientation of commercial life had been recognised by a series of cooperative ventures by Australian governments, including the National Rail Corporation, road transport regulation and non-bank financial institutions;
- The nearest Australia came to nationally consistent competition policy principles was the competitive conduct rules contained in Part IV of the Trade Practices Act. However, the biggest deficiency in the Act was that it remained limited in its application, with coverage often depending on questions of ownership or corporate form rather than considerations of community welfare.[4]

On 26 February 1992 the Prime Minister Hon PJ Keating MP released his *One Nation* statement.[5] In regards to competition, the Prime Minister wrote:

> It is no accident that Australia's most efficient and commercially successful producers have been those which have been subject to strong competition. And the most stringent competitive standards are those in world markets….
>
> Suppliers of goods or services which are protected from international competition:
>
> - Are not subject to the pressures which ensure efficient management and production techniques or delivery of very high quality products;
> - Can get away with shoddy or overpriced goods and services without fear of loss of markets.
>
> When this occurs in sectors that service others, the effect is doubly damaging and debilitating for the rest of the economy. It imposes higher prices and poorer services on Australian consumers. And it puts those Australian companies competing overseas at

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3 Commonwealth of Australia, *National Competition Policy*. *Report by the Independent Committee of Inquiry*, August 1993, at 11.

4 Commonwealth of Australia, *National Competition Policy*. *Report by the Independent Committee of Inquiry*, August 1993, at 13.

5 Commonwealth of Australia, *One Nation. Statement by The Prime Minister The Honourable P.J. Keating MP*, 26 February 1992.

> a competitive disadvantage…
>
> To keep up with the rest of the world and to secure opportunities open to Australia the pace of reform must be accelerated and widened.

2.1 The Hilmer Report and the development of National Competition Policy

In 1992, the Council of Australian Governments commissioned Professor Fred Hilmer to undertake an "Independent Committee of Inquiry into National Competition Policy". The subsequent report, known as the Hilmer Report, was released in August 1993.

Acting on the Hilmer Report's recommendations, a number of reforms were drawn together in 1995 to form a package, agreed upon by all Australian Governments, and called National Competition Policy.

The reforms can be briefly outlined as follows:[6]

- The extension of 'Trade Practices' laws prohibiting anti-competitive activities (such as the abuse of market power and market-fixing) to all businesses – previously most government owned and some private businesses were exempt;
- The introduction of 'competitive neutrality' so that privately-owned businesses can compete with those owned by Government on an equal footing;
- The review and reform of all laws that restrict competition, unless the benefits of the restriction to the community as a whole outweigh the costs, and the restrictions are needed to attain the benefits;
- The development of a "National Access Regime" to enable competing businesses to use nationally significant infrastructure (like airports, electricity cables, gas pipelines and railway lines);
- Specific regulatory reforms to the gas, electricity, water and road transport industries.

In agreeing to the National Competition Policy reform package, the Commonwealth and State/Territory Governments signed three agreements. These were:[7]

- The Conduct Code Agreement – operating in conjunction with the Competition Policy Reform Act 1995, established processes for amending the competition laws of the Commonwealth and States/Territories to extend the coverage of the Trade Practices Act 1974 to all business in Australia, irrespective of their ownership;
- The Competition Principles Agreement – established reform principles in relation to access for essential infrastructure; structural reform of government monopolies; fair competition between government businesses and the private sector, reviewing the merits of anti-competitive legislation, and the application of competition principles to local government. Clause 1(3) of the Agreement also sets out the public interest test to enable governments to assess the merits of proceeding with particular reforms;

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6 See National Competition Policy website: http://www.ncc.gov.au

7 National Competition Council, *National Competition Policy: Some Impacts on Society and the Economy*, January 1999, at 25.

- The Agreement to Implement the National Competition Policy and Related Reforms – this incorporated COAG reform agendas for the electricity, gas, water and road transport industries into the NCP framework. The Agreement also established the conditions for financial transfers (National Competition Policy Payments) from the Commonwealth to the States, and the timetable for implementing reform.

The provision of National Competition payments recognised that the National Competition Policy reforms provide dividends to Commonwealth revenues. The payments are an economic dividend paid by the Commonwealth to States and Territories in return for their investment in reform. Satisfactory progress against the National Competition Policy obligations is a prerequisite for States and Territories to receive full payment because without reform implementation, there can be no reform dividends to share. The National Competition Policy payments are available over the period 1997-98 to 2005-06. Payments to NSW are indicated in Table 1 below:

Table 1: Actual and Estimated National Competition Policy Payments to NSW ($million)[8]

1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
211.9	156.5	241.5	248.0	253.5	260.4	267.4

As part of the reforms, the National Competition Council was established. The Council is a policy advisory body and provides national oversight of National Competition Policy. The Council, a statutory body, is funded by the Commonwealth, with responsibilities to all Australian governments. The Council is comprised of five part-time councillors drawn from different business sectors and parts of Australia. It is supported by a secretariat of around twenty staff located in Melbourne. The National Competition Council's formal assessments of State and Territory reform progress includes recommendations to the Commonwealth Treasurer on the level of competition policy payments.

As noted above, one element of National Competition Policy required Governments to identify and review legislation that restricted competition. Across all Australian governments, about 1700 pieces of legislation were identified to be reviewed. On 3 November 2000 the Council of Australian Governments extended the timeframe for completion of the legislation review component of the reforms from December 2000 to June 2002.[9]

When reviewing legislation, National Competition Policy requires Governments to identify and change their laws when the restrictions on competition are not justified by public

8 National Competition Council (2000) Annual Report 1999-2000, AusInfo, Canberra, at 52.

9 See National Competition Policy website: http://www.ncc.gov.au

interest. It is recognised that there are circumstances where restrictions on competition are justified. Therefore, each law must be assessed against a number of criteria including specific public interest considerations; whether there are other ways of achieving the objectives of the laws without hindering businesses and, whether the benefits of the laws outweigh the costs.

The factors to be assessed in determining what is in the public interest were defined in the Competition Principles Agreement. These included:

- Laws and policies relating to ecologically sustainable development;
- Social welfare and equity, including community service obligations;
- Laws and policies relating to matters such as occupational health and safety, industrial relations, access and equity;
- Economic and regional development, including employment and investment growth;
- The interests of consumers generally or of a class of consumers;
- The competitiveness of Australian businesses;
- The efficient allocation of resources.

The list is open-ended, meaning that Governments must also take into account any other matter relevant to determining the merits of the reform being examined.[10] Whilst the above factors to be taken into account seem comprehensive, as will be noted later in this Paper, it is the application of the public interest test that has attracted some of the most severe criticism in the implementation of competition policy.

The National Competition Council has accepted that the implementation of competition policy is not necessarily going to be easy. However, the Council also noted that the economic pressures that drove the development of the NCP program have not gone away and the recent Asian financial crisis has re-emphasised the importance of having a flexible, internationally competitive economy. The Council concluded that by working to ensure that conditions for competition prevail, Governments will promote growth, innovation and productivity helping to raise the living standards of the Australian community.[11]

Ed Willet, Executive Director of the National Competition Council, summarised competition policy as follows:

> There is a fundamental philosophy behind national competition policy which is as relevant today as it was five years ago.
>
> That is, competition is about choice, giving consumers the means and freedom to choose between products and suppliers.
>
> Where there is a choice between businesses offering similar products, prices tend to fall and quality improves.

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10 See National Competition Policy website: http://www.ncc.gov.au

11 See National Competition Policy website: http://www.ncc.gov.au

> The theory is pretty much unarguable.[12]

However, a number of commentators on national competition policy have argued quite strenuously that the national competition policy theory is indeed very arguable. For instance, Ted Kolsen from the University of Queensland argued that in economics, the basic model of economic efficiency initially makes a number of assumptions designed for clarity of thought – not realism. The basic model is one of universal perfect competition, with perfect knowledge about present and future, in the absence of unpaid externalities or government intervention, without concern for the distribution of income. In such a market, large numbers of firms, each supplying an insignificant amount of the total product, instantaneously adjust to any changes in demand, and always produce where price equals marginal cost.[13]

However, as Kolsen maintains, no economist would suggest that such a model is of any direct use for policy. The 'model' is progressively changed by removing some of its assumptions. When this is done, Kolsen argued that it becomes apparent that the guides to economic efficiency drawn from the perfect competition model not only need modification, but may have to be replaced entirely. This was shown by the theory of second best[14], which was developed in 1956-57 by the economists Lipsey and Lancaster. Prior to the development of this theory, it had been widely held that because more competition results in prices being closer to marginal cost, this would make the allocation of resources more efficient because it would be closer to what would occur under perfect competition. However, according to the theory of second best, the view that increased competition leads to the more efficient allocation of resources would be frequently invalid where many sectors in the economy were not perfectly competitive.[15]

Following this argument, Maddock of La Trobe University noted: "The easiest criticism of the Hilmer Report comes through the theory of second best. The Report assumes quite glibly that welfare increases by partially removing a whole range of restrictions on

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12 *The Future of National Competition Policy*, Speech by Ed Willet, Executive Director, National Competition Council, IIR Conference, Darling Harbour, Sydney, 20 November 2000.

13 Kolsen,T "Microeconomic reform and national competition policy: misconceptions and *In Australian Journal of Public Administration*, Vol 55 No 2, June 1996 at 84.

14 This theory can be explained as: "In general, if government policy can alter the behaviour of only one sector of the economy, making that sector follow the perfectly competitive rule of price equals marginal cost may raise the economy's overall efficiency or lower it or leave it unchanged. The basic reason is that the policy affects not only the behaviour of that sector but of all other sectors as well and in each of the other sectors, where perfect competition does not rule, the changes can improve or worsen efficiency."

See: Lindsay,R., Langley,P., Mahoney,D., *Positive Economics for Australian Students*, Second Edition, Weidenfeld and Nicolson London, 1985, at 499.

15 Kolsen,T "Microeconomic reform and national competition policy: misconceptions and *In Australian Journal of Public Administration*, Vol 55 No 2, June 1996 at 84.

competition. This is clearly false and simply wishful thinking."[16] Maddock argued that the classical argument that competition leads to efficiency which leads to welfare maximisation cannot be sustained except in very special circumstances which are unlikely to hold.

The Australia Institute argued in a similar manner to Kolsen and Maddock in their submission to the NSW Legislative Council Privatisation of FreightCorp Inquiry. The Institute argued:

> One of the major objectives of privatisation, and National Competition Policy more broadly, is to reduce the cost of production of goods and services in Australia. The rationale for such an approach has been that allocative efficiency in the macro-economy can be improved if inputs such as electricity, water and transport can be produced at lower cost. Lower input costs, it is argued, will result in lower prices for final goods and services, increase exports and increased employment.
>
> The notion that reduced production costs lead to an increase in allocative efficiency, and in turn welfare, is explicitly based on the assumptions of the perfectly competitive model, including the assumption that there are no externalities present in either the production or consumption of goods and services.[17]

The Institute then argued that in fact significant externalities are present, and that the theory of second best showed that enhancing competition in one sector of the economy may result in an overall reduction in the welfare of society.[18]

However, the fact is that the most influential theory amongst policy makers at the moment is that of neo-classical economics, which is generally associated with the term 'economic rationalism'. The conventional wisdom of neo-classical economists is that the best way to achieve more efficient use of resources is to promote competition amongst the providers of goods and services, and that where competitive markets are weak or non-existent, so are the incentives for producers to use resources more efficiently.[19]

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16 Maddock,R "Microeconomic reform as constitutional political economy: A commentary on *Economic Papers*, June 1994, at 35.

17 NSW Legislative Council, General Purpose Standing Committee No 4, *Privatisation of FreightCorp*, Report 6, December 2000, at 4.44.

18 NSW Legislative Council, General Purpose Standing Committee No 4, *Privatisation of FreightCorp*, Report 6, December 2000, at 4.47.

19 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 5.

3.0 REVIEWS OF NATIONAL COMPETITION POLICY

There have been several important reviews of national competition policy over recent years. These include publications from the Productivity Commission, the National Competition Council and the Commonwealth Parliament. Each of these reports are discussed below.

3.1 The Productivity Commission Review

In September 1999 the Productivity Commission released its report *Impact of Competition Policy on Rural and Regional Australia*.[20] The Report placed competition policy in the context of economic and social change for Australia. The Commission noted that trade and foreign investment have always been important to country Australia, and that more recently the scale and pace of globalisation have intensified adjustment pressures in some regions and created growth opportunities in others. Factors affecting the fortunes of country Australia were identified to include:

- Technological advances, such as improved transport and telecommunications, increased mechanisation of farming, agronomic developments and adoption of new mining techniques;
- A downward trend in the world prices for agricultural commodities, which has been reflected in a decline in producers' terms of trade;
- Changes in consumer tastes, such as the decline in the demand for wool and increased expenditure on tourism;
- Changes in lifestyle, such as an increase in internal migration to coastal areas;
- Government policy changes, such as lowering trade barriers, deregulating the financial system and increased regulation to protect the environment.[21]

The Commission noted that these forces have contributed to significant changes in the composition of Australia's economic activity, with different regional implications across country Australia. For instance, the combined share of agriculture and mining contribution to Australia's gross domestic product has declined from 24 percent in 1948-49 to around eight percent today. This decline reflects the rapid expansion of service activities.[22]

Noting the social and economic changes across Australia, the Commission found that broad long-term economic forces which are beyond the control or influence of governments have been key drivers of the economic and social changes of particular relevance to country Australia. These include: changing technology and increasing productivity; rising incomes

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20 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999.

21 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at xxvi.

22 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at xxvi.

and changing lifestyles; and declining world agricultural and mineral commodity prices.[23] With this background the Commission then assessed the effects of each component of competition policy on rural and regional Australia, and the results of this are summarised in the next section.

3.1.1 National Competition Policy related Infrastructure Reforms

The Commission noted that the potential gains from reforms in the electricity, gas, water and road transport sectors are substantial. As these services are important to most industries, their more efficient provision has a significant role to play in improving industry competitiveness, and access to infrastructure services is essential to a basic quality of life. Intergovernmental reforms to improve the provision of infrastructure services began more than a decade ago, and were incorporated into the National Competition Policy in 1995.[24]

Electricity Reform

Electricity accounts for around 18 percent of Australia's energy consumption and some 66 percent of the commercial and 42 percent of the residential segments of the energy market. The manufacturing sector is the largest user of electricity, and is particularly important for alumina and pulp and paper production – two industries located primarily in regional areas. Prior to reforms, electricity supply in Australia was characterised by publicly owned, vertically-integrated monopoly suppliers, which operated in separate, extensively regulated markets. The Commission noted that this industry structure gave rise to significant over-manning and over-investment, particularly in the generation segment, and inflated electricity costs and prices. Electricity tariffs bore little resemblance to the cost of supplying different classes of users.[25]

The regional impacts of electricity reforms

The Commission stated that while the electricity reforms appear to have delivered benefits to Australia as a whole, in rural and regional Australia the outcomes to date have been more mixed. For example, while many users in country Australia, such as large businesses, have benefited from large price reductions, smaller users in some areas have experienced price increases. Similarly, while rationalisation of maintenance depots has resulted in a net fall in employment, some regional centres have gained extra jobs, sometimes at the expense of jobs in adjacent small towns. The Commission noted that labour shedding in regional areas has been, proportionately, little different from that in urban areas. In absolute terms, employment losses in urban areas have been higher than in regional areas. However, the capacity of smaller country towns to absorb employment losses is generally less than in the larger cities and regional centres. This is particularly the case when such losses are added to employment reductions stemming from other parts of the NCP and economic change

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23 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, Finding 3.4, at 78.

24 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 97.

25 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 99.

more generally.[26]

Gas

Natural gas accounts for 18 percent of Australia's energy consumption, and is our fastest growing energy source. However, the Commission determined that the major adverse effect of the gas reforms has been a loss of employment in the industry, mostly in metropolitan areas. Indeed, for country Australia, the main benefit of the reforms has been the stimulus provided by the extension of the gas network and the associated opportunities this has created for existing and new businesses.[27]

Water

The Commission noted that the water industry is one of Australia's largest, with assets valued at over $90 billion in replacement cost terms. Some $40 billion of these assets are in country areas, and around 90 percent of water supplied to non-metropolitan areas is used to irrigate crops and pastures. Historically, government provision of water infrastructure was often used to support regional development in rural and remote Australia. However, water reforms now seek to improve the economic viability and ecological sustainability of water supply.

In February 1994, COAG endorsed a reform framework for the Australian water industry, to be implemented progressively through to 2001. Major reforms pertinent to this paper include: pricing reforms; investment reform; and allocation and trading reforms. With the April 1995 signing of the National Competition Policy agreements, implementation of these COAG initiated water reforms became a formal requirement under NCP.

The Commission found that there had been a significant reduction in direct employment by water authorities during the 1990s. However, the net effect on employment is difficult to determine as water authorities have outsourced many of their activities, and many of their regulatory functions are now performed by organisations external to the water supply industry. In rural areas, centralisation of service provision has led to employment losses in the water industry in smaller rural communities, but these have been partially offset by gains in employment in the larger regional centres. For example, a submission from the Gwydir Valley Irrigators Association indicated some 50 water jobs recently lost in Moree had transferred to Tamworth.[28]

Road Transport

The road transport sector is a significant component of the Australian economy. It directly employs around 193,000 people, and accounts for slightly more than two percent of gross domestic product. Country Australia relies heavily on road transport to bring in goods and to move goods out to users and ports. Concerted efforts to improve the efficiency of the

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26 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 118.

27 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 131.

28 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 159.

road transport sector on a national basis began in the early 1990s. In 1995, under the Implementation Agreement of the NCP, governments recommitted themselves to 'effective' observance of the road transport reforms.
In comparison to other areas, the NCP Implementation Agreement provides only very general guidance to governments on their obligations in the road transport area. The Commission noted that transport reform has been relatively slow, especially when compared to other sectors such as electricity. The Commission concluded that there is little evidence on the impacts of NCP related road reforms due to the slow progress in implementing those reforms. However, country areas have derived some benefit to date from the reductions in regulatory overlaps and inconsistencies between jurisdictions.[29]

Reform of Public Monopolies
The Commission noted that National Competition Policy did not initiate structural reform of public monopolies, and that in fact these reforms were well advanced before NCP commenced. The Competition Principles Agreement does not require governments to introduce competition or privatise their monopolies, although many are now subject to competition. The Commonwealth and State Governments agreed that they would review the commercial objectives, the effective implementation of competitive neutrality, industry regulation and allow access by other businesses to significant infrastructure in public ownership.[30]

The Commission then looked at the progress of reform with rail and ports, and, in relation to the Commonwealth, Telstra and Australia Post. The Commission noted that in spite of the slow progress and diffuse nature of reform of the railways, rail reforms have produced some significant gains in productivity, cost savings and service quality. For instance, over the period 1989-90 to 1996-97, annual average labour productivity growth in Australian rail freight was 13 percent, while costs per net kilometre of transporting freight by rail have declined by 25 percent over the past ten years.

The Commission noted that in country Australia rail transport is used significantly, especially in the transport of commodities. For example, 70 percent of grain production and 80 percent of coal production is transported by rail. The Commission noted that whilst the improved performance of rail has and will bring price benefits to country areas, the adverse impacts of loss of employment has had a significant impact on rural and regional Australia. Restructuring and rationalisation of rail enterprises has resulted in railway employment declining more rapidly in country Australia than in capital cities. In 1986, more than half of Australia's full-time railway employees were located outside Australia's capital cities, but by 1998 this proportion had declined to around one-third.[31]

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29 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 167.

30 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 171.

31 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 174.

Ports

The management of ports in Australia has traditionally been a function of State governments. The reform process has involved corporatisation, separation of the regulatory elements from the commercial elements and the provision of dividends and tax equivalent regimes. Benefits of the reform process include port authority charges being reduced by more than 23 percent over the five years to 1996-97. The Commission noted that the reductions in port charges are of significant benefit to country Australia, given the high level of export orientation in Australian agriculture.[32]

Commensurate with the reduction in port charges has been the decline in employment. In the three year period to 1991-92, employment declined by 40 percent from around 6000 to just over 3500. Between 1991-92 and 1996-97, employment fell to 1677, a reduction of just over 50 percent. However, these reported losses of employment may be overstated as some of these ‘lost’ jobs may have been absorbed by private firms undertaking the work contracted out by the port authorities.[33]

Commonwealth Reforms

Telstra

Major structural reforms in telecommunications commenced prior to the NCP. These included the corporatisation of Telecom and the introduction of limited competition. Telecom maintained a monopoly over all telephone services in Australia until limited competition was introduced in 1991. The limit on carrier licences has since been lifted. The regulatory control over competition in telecommunications is the responsibility of the Australian Consumer and Competition Commission.

The Commission noted that concerns relating to Telstra services and operations in country Australia were raised constantly during the Inquiry. The introduction of competition into telecommunications and the partial privatisation of Telstra were seen by many as benefitting urban areas, but of little benefit or even a negative impact on country areas.

Employment in Telecom/Telstra declined from more than 86000 in 1987-88 to around 67000 in 1997-98. The decline in Telstra employment between 1992 and 1999 was larger in non-metropolitan than in metropolitan areas. The reduction in employment and incomes from the closure or reduced size of a Telstra depot is likely to represent a larger share of total employment and income in a country town that in a metropolitan centre or larger town. For example, the loss of 70 Telstra jobs in the town of Narrandera represented nearly 3 percent of the shire’s total workforce.[34]

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32 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 176.

33 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 176.

34 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 185.

Australia Post

Australia Post was corporatised in 1989, and operates a legislated monopoly in certain markets. For example, only Australia Post is able to carry a standard letter. The Commission noted that concerns expressed about a perceived decline in post office services in country Australia were not supported by the statistics. Whilst there was a decline in the number of corporate post offices (ie, those operated by Australia Post) in rural and remote Australia, these were offset by an increase in the number of licensed post offices or agencies. Australia Post employee numbers in 1987-88 were close to 39000. As at June 1997, there were 31000 full time and 6200 part time staff.

The Commission concluded that the impacts on country Australia from the changes to Australia Post have generally been positive. The cost of posting a letter in both country Australia or in metropolitan areas remains the same, the real price of posting a standard letter has fallen, service standards remain high and the number of retail outlets in non-metropolitan areas has increased.[35]

3.1.2 National Competition Policy and the Marketing of Rural Products

Statutory marketing arrangements have their origins in voluntary cooperatives in the early 1900s. Through these cooperatives, groups of producers sought to increase their returns by controlling the processing and marketing of produce. In the 1920s, some cooperatives sought and gained statutory backing for ‘compulsory cooperatives’. Wartime regulation expanded the use of compulsion and it became an integral component of the pricing and marketing framework for many agricultural industries.[36]

Statutory marketing arrangements have been subject to increased scrutiny since the 1970s, with all States initiating reviews of them in the 1980s and 1990s. The legislation review part of the NCP aims to ensure that legislation does not restrict competition unless it can be shown that the benefits to the community as a whole outweigh the costs. Legislation underpinning statutory marketing arrangements was required to be reviewed because it is potentially anti-competitive.

The Commission noted that given the diversity of agricultural commodities, it is difficult to draw general conclusions about the effects of reform. However, the Commission noted that the removal of some statutory marketing arrangements undoubtedly would expose some agricultural producers to significant adjustment pressures. The severity of the effects of ending anti-competitive measures are likely to vary from region to region depending on:[37]

- The magnitude of the transfer;

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35 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 192.

36 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 195.

37 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 224.

- The extent to which the value of anti-competitive regulation has directly been capitalised into asset values;
- The significance of commodities covered by anti-competitive arrangements in particular regional economies;
- The scope for farmers to diversify into other agricultural pursuits;
- Alternative employment opportunities outside agriculture.

Other considerations which the Commission concluded may influence the regional effects of reform include: farmers' capacity to offset lower prices through productivity improvements and farm amalgamations, or by switching into new, higher value crops; and the ability of farmers to institute alternative arrangements for capturing economies of scale in marketing, for instance, without recourse to anti-competitive legislation.

The Commission noted that reforming statutory marketing arrangements can pose difficulties for policy makers because the costs of reform to individual producers can be substantial, whereas the benefits to dispersed consumers may run to a few cents per purchase.[38]

3.2 Summary of Impacts of National Competition Policy Reforms, as identified by the Productivity Commission

The Commission noted that NCP reforms come on top of many other factors affecting economic and social conditions more generally in the community. In addition, the accurate assessment of economy wide and regional effects of NCP is complex and difficult. Nevertheless, the Commission identified and distinguished between two types of effects – short-term or transitional effects and long term, or on-going effects which apply once the reforms have been implemented.

Displaced railway or electricity workers for instance, bear short-term costs of loss of income as they seek new employment. If this involves relocating their families, the short term costs are increased. The Commission noted that this is more likely in country than metropolitan areas, and if there are many displaced workers in a region. In addition, there may be private loss of capital if displaced workers have to sell their houses in a property market weakened by them all seeking to sell at the same time. In turn, the loss of people has an impact on the local providers of services such as shops, schools, banks, health facilities, councils and on the general social diversity provided by larger communities. The Commission also noted that if there is a long time before another job is found, then the costs are no longer short-term.[39]

However, the Commission argued that in contrast to many of the costs, the benefits stemming from infrastructure reforms typically endure. The financial benefits may be

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38 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 224.

39 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 285.

reflected in increased dividends (or decreased costs) to governments and usually lower prices to consumers. The Commission considered that improved competition, coupled with increases in consumer spending power associated with NCP price reductions, will stimulate higher output and create additional jobs.

The Commission quantified the possible long-term impacts of NCP reforms and explored differences between country and metropolitan Australia. However, the Commission noted that the results of the modelling need to be interpreted with care as simplifying assumptions have been used to incorporate the NCP reforms. The model, called MONASH-RR, divided the economy into 113 industries and 115 commodities. The States and Territories were separately listed, with each state divided into 55 statistical divisions.

The economy wide results of the modelling indicated that real gross domestic product would be 2.5 percent higher than what would have been the case in the absence of the NCP reforms. The estimated annual gain in real household consumption is 2.8 percent, exports are up 3.4 percent and imports up 2.0 percent compared to what would otherwise occur in the absence of reforms.[40]

The Commission also reported the results for regions within the States, with the result for regions in NSW shown in Table 2 below.

Table 2: Estimated regional impacts of NCP reforms[41]

Region	Gross regional product %	Employment %	GRP per worker
New South Wales	2.6	0.1	2.5
Sydney	2.6	0.2	2.4
Hunter	4.0	1.5	2.4
Illawarra	3.7	1.5	2.2
Richmond-Tweed	2.2	-0.5	2.7
Mid North Coast	1.9	-1.3	3.2
Northern	1.8	-1.1	2.9
North Western	2.2	-0.5	2.7
Central West	2.2	-1.0	3.3
South Eastern	1.8	-1.8	3.6
Murrumbidgee	1.7	-1.5	3.2
Murray	1.7	-1.4	3.1
Far West	3.3	0.8	2.5

Table 2 clearly shows that whilst gross regional product has improved across all regions, all regions (apart from the Far West) away from the Hunter – Sydney – Illawarra metropolitan

40 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 298.

41 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 301.

area suffer a negative change in employment. The most severe of these is the South Eastern region, with a negative 1.8 percent change in employment. Clearly, according to the modelling of NCP by the Productivity Commission, there has been a drop in employment in the regions which can least absorb job reductions.

The Commission concluded that in summary, the estimates of long-term effects from the model indicate there are considerable gains to the Australian community from implementing the NCP reforms. However, within this gain, there is quite a varied set of results, with individual reforms estimated to produce different effects, and these effects are different across regions.[42]

Mr Plunkett from the Productivity Commission summarised the conclusions of the report as:

> The overall conclusion we reached was that Australia as a whole is likely to benefit from NCP, although there is more variation in the incidence of benefits and costs amongst the regions. To date, the reforms implemented have provided greater benefits to large businesses and people in metropolitan areas, because that is where the markets were opened up first – in infrastructure areas.[43]

The National Competition Council has also recognised that whilst the employment effects of NCP are diverse, there are strong community perceptions that the effects are mainly negative. This is because the negative employment effects of competition often occur relatively quickly, and tend to be concentrated among particular groups, industries or geographical areas directly exposed to competition. In contrast, the Council argued that employment benefits of competition reform tend to flow more evenly across the community and economy through cheaper costs and prices and the expansion of industry arising from these changes.[44]

3.3 The Senate Select Committee on the Socio-economic Consequences of the National Competition Policy

On 1 July 1998, the Australian Senate established the Select Committee on the Socio-economic Consequences of the National Competition Policy. This inquiry was cut short with the 1998 federal election, and the Committee was re-established on 9 March 1999. The Committee released an interim report on 26 August 1999,[45] which, in relation to areas

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42 Productivity Commission, *Impact of Competition Policy on Rural and Regional Australia,* Report No 8, September 1999, at 305.

43 Parliament of the Commonwealth of Australia, *Riding the Waves of Change*. A Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, February 2000, at 5.11.

44 National Competition Council, *National Competition Policy: Some impacts on society and the economy*. January 1999, at 59.

45 Parliament of the Commonwealth of Australia, *Competition Policy: Friend or Foe. Economic Surplus, Social Deficit?* An Interim Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, August 1999.

concerning this Paper, found the following:[46]

- That there is an understanding that there are benefits flowing from NCP, although the level of acceptance of the benefits that NCP can deliver has varied, as has the level of understanding of the policy;
- NCP has become the 'lightning rod' for the many negative social and structural changes that are occurring in Australia, particularly in rural and regional areas;
- The lack of employment in rural centres and further decreasing employment opportunities, with the loss of youth as they move to the larger towns or cities in search of work are recognised as serious issues. In addition to their impact they compound the loss of banking, postal, shopping and other community and health services as the smaller towns gradually close;
- The cumulative effects of changing technology, infrastructure provision, the wide range of micro-economic reform policies including NCP, and globalisation of the economy, on rural and regional areas warrant greater attention.
- The cumulative effect of these influences, rather than solely NCP, on rural and regional Australia is creating significant social pressures, and it is apparent that the impacts of these policies has been disproportionate between metropolitan and country areas.
- Technological and other advances are enabling regional Australia to produce more goods and services with fewer people.

In the Select Committee's final report, it was noted that anecdotal evidence painted a picture of a loss of social cohesion and human capital in small rural and remote areas. The Committee reserved its greatest criticism for national competition policy in regards to the application of the public interest test, as noted below:

> There is anecdotal evidence of a loss of social cohesion, amenity and human capital in small rural and remote communities. In the opinion of the Committee, the improper application of the public interest test [of NCP] or the inadequate definition of community service obligations may be contributing to this. It is the Government's responsibility to ensure that each of is citizens receives, as part of community welfare obligation, equitable access to basic health and welfare services, telecommunications, education, transport and housing. There would appear to be a perception rightly or wrongly, that either the services are being inadequately provided or the government is abandoning its responsibility in this regard. The Committee is concerned about the continuing confusion and lack of sophisticated knowledge about NCP in remote, rural and regional communities in particular. The Committee is of the view that there is a need for an information and advisory service on the application of NCP.[47]

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46 Parliament of the Commonwealth of Australia, *Competition Policy: Friend or Foe. Economic Surplus, Social Deficit?* An Interim Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, August 1999, at xi to xiv.

47 Parliament of the Commonwealth of Australia, *Riding the Waves of Change*. A Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, February 2000, at 5.72.

3.4 National Competition Policy and the Public Interest Test

The National Competition Council noted that whilst the NCP package in its entirety was designed to serve the public interest, several of the individual reforms are subject to additional safeguards to weigh the costs and benefits of reform on a case by case basis. These public interest safeguards arise in several contexts of the NCP program. These are:

- The merits of proceeding with three key reforms – competitive neutrality, the structural reform of public monopolies, and the reform of anti-competitive legislation – are subject to a public interest test;
- One of the criteria for declaring infrastructure services for third party access under the Trade Practices Act is that access must not be contrary to the public interest;
- Authorisation of anti-competitive practices prohibited by the *Trade Practices Act* can be sought from the ACCC on the grounds of net public benefits;
- The Council may be called upon to weigh the costs and benefits of Commonwealth or State/Territory laws providing statutory exemptions from the *Trade Practices Act*.[48]

As noted in section 2.1 of this Paper, under clause 1(3) of the Competition Principles Agreement, Governments must take into account the following factors when determining what is in the public interest:

- Laws and policies relating to ecologically sustainable development;
- Social welfare and equity, including community service obligations;
- Laws and policies relating to matters such as occupational health and safety, industrial relations, access and equity;
- Economic and regional development, including employment and investment growth;
- The interests of consumers generally or of a class of consumers;
- The competitiveness of Australian businesses;
- The efficient allocation of resources.

The National Competition Council noted that the public interest test is neither exclusive nor prescriptive. It provides a list of indicative factors a government could look at in considering the benefits and costs of particular actions, and allows other factors to be taken into account. The Council stated that its approach is that the NCP agreements give social and environmental values no more or less weight than financial considerations in determining where the public interest lies, ie, all the public interest factors intrinsically carry equal weight. The Council noted that the challenge for review bodies and governments is to focus on outcomes that benefit the community as a whole, as well as take into account the impacts of reform on the individual, regions and industries directly exposed to reform.[49]

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48 National Competition Council, *National Competition Policy: Some Impacts on Society and the Economy*, January 1999, at 95.

49 National Competition Council, *National Competition Policy: Some Impacts on Society and the Economy*, January 1999, at 97.

However, in regards to the public interest test, the Senate Select Committee on the Socio-economic Consequences of the National Competition Policy stated the following:

> Failure to properly apply the public interest test is at the heart of much of the problems with NCP in rural and regional Australia.[50]

The Committee noted the difficulties in interpreting and understanding the public interest/public benefit test, including:[51]

- A lack of understanding of the policy;
- A predominence of narrow economic interpretation of the policy rather than wider consideration of the externalities;
- A lack of certainty between States and Territories as differing interpretations of the policy and public interest test, result in different applications of the same conduct;
- Lack of transparency of reviews; and
- Lack of appeal mechanisms.

The Committee noted its concerns about the application of 'public interest' given the confusion that exists over what the term means or allows under NCP. The Committee considered that this confusion, combined with the administrative ease of simply seeking to measure outcomes in terms of price changes, encourages the application of a narrow, restrictive definition.

Other commentators have also concurred with the Senate Select Committee's position. For example, Rai Small from the Public Sector Research Centre identified concern about the method of identifying and evaluating the public interest. In terms of the National Competition Council's guidelines that equity and social welfare aspects of the public interest test carry the same weight as economic issues, questions raised by Small include: "How experienced are decision makers in valuing issues of equity and environmental sustainability? Economic elements are generally more open to quantification than social issues. Does this mean that in practice the former are given greater weight?" Small notes that local government in particular is likely to have difficulty in implementing the public interest test proficiently.[52]

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50 Parliament of the Commonwealth of Australia, *Riding the Waves of Change*. A Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, February 2000, at 5.53.

51 Parliament of the Commonwealth of Australia, *Riding the Waves of Change*. A Report of the Senate Select Committee on the Socio-economic consequences of the National Competition Policy, February 2000, at 4.1

52 Small, R. "Public Sector Research Centre", in Paddon, M and Small, R (Eds) *Competition: In whose interest? The socio-economic impacts of National Competition Policy*, 1999, at 43.

3.5 The Views of the Australian Catholic Social Welfare Commission

An example of community sector views on national competition policy is the submission of the Australian Catholic Social Welfare Commission to the Productivity Commission Inquiry into the Impact of Competition Policy, which is summarised below.

In their submission the Australian Catholic Welfare Commission outlined what they considered to be four key responsibilities that should be achieved when pursuing social and economic development through the implementation of national competition policy. These principles were:

- Responsibility to enhance the common good;
- Responsibility to ensure distributive justice;
- Responsibility to ensure people participate in the life of the community;
- The role of responsible government.[53]

The Commission noted that it would be a mistake for governments, when pursuing NCP, to assume that the service of a majority, or even a minority, of consumers necessarily attains the common good. The Commission considered that one of the basic yardsticks of the common good is ensuring that human dignity and rights are given to the most disadvantaged 'consumers' in our community.

The Commission noted that the concept of community service obligations comes closer to the Church's understanding of the common good. However, the Commission noted that whilst government's are moving to apply the NCP to all aspects of their operations, it is inevitable that the number of government activities quarantined from the impact of competition policy will be kept to a minimum. The Commission considered that there needs to be greater discussion about which government activities should be quarantined from the NCP and which government activities should be subject to CSOs.[54]

In regard to the second responsibility, that of ensuring distributive justice, the Commission noted that Catholic tradition holds that the goods and burdens of a community are to be distributed on the basis that not all persons can contribute in the same way. The Commission argued that the principle of distributive justice advocates a thorough investigation of and, where appropriate, an alteration of the distributive macro-systems of the market and social wage. This is needed to ensure a more equitable spread of income generated wealth and employment opportunities throughout a community, and with a special regard for those regions and groups most disadvantaged.[55]

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53 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 7-15.

54 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 10.

55 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on*

The Commission questioned whether the National Competition Council considers the issue of equity relevant when the NCC stated in its 1997-98 Annual Report:

> …improving equity is not the central focus of the NCP package. Rather the NCP agreements simply require that all competition reviews consider 'social welfare and equity considerations' when assessing the case for reform. While this will tip the scale in favour of decisions that enhance equity, in practice reforms are likely to have a range of effects on equity – some good, some bad.[56]

The Commission noted that some of the outcomes of NCP are often experienced in negative terms. The Commission argued that government assistance, support and intervention must not be allowed to be redefined by the proponents of NCP as outmoded 'charity' ideals that have no place in government policy and strategies. It considered that the ultimate success of the NCP will depend on how it treats those 'consumers' who are the most disadvantaged – not only in financial spending power but in their access to the full range of services available to the majority of Australians.[57]

The third argument made by the Commission was that governments have a responsibility to defend and promote civil structures as being both prior to and the necessary basis upon which to ensure the right of people to participate in the life of the community. The right of citizens to participate in the life of their community reinforces the role of government, and particularly the Commonwealth government, to provide substantive guarantees of, amongst other things: each individual's right to work; market income security; and guaranteed income support when unemployed. The Commission argued that the responsibility of government, and NCP, ought to be the pursuit of full employment as a key component of economic development.

The fourth principle to judge NCP by according to the Commission was that of the role of responsible government. The Commission noted that good government is about seeking the development of a harmonious and equitable society in which the dignity of all is protected. It noted that most people interact with the economic market to satisfy their needs. Where people are unable to satisfy their needs in this manner, the government is entrusted with the responsibility of protecting the human dignity and rights of these people.[58]

The Commission noted that governments can never abdicate their part in the fostering of social development to societal institutions such as the churches. In turn, the Commission

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Rural and Regional Australia, December 1998, at 10.

56 National Competition Council, *Annual Report 1997-98*, at 35.

57 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 12.

58 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 17.

noted that neither can governments expect churches or the non-government sector to build up social cohesion when the actions taken by government through competition policy, competitive tendering and contracting are contributing factors to the breakdown of local communities.[59]

The next section of this paper presents an industry case study on the effects of deregulation and NCP.

4.0 A DEREGULATION CASE STUDY – THE DAIRY INDUSTRY

There has been a considerable amount written about the dairy industry over the last decade, which has mirrored the gradual deregulation of the industry. The dairy industry has moved from being in an intensively regulated environment to one of deregulation, and is currently in a state of adjustment. This section of the Paper briefly summarises the history of deregulation, and reports on the effects of deregulation on the dairy industry.

Dairy farming is Australia's fourth largest rural industry, behind wheat, beef and wool. The dairy industry consists of four sectors: production; processing; manufacturing and distribution/vending. The production sector includes those activities which are generally undertaken at the farm level. Processing involves the treatment of raw milk and packaging for consumption as fresh milk. Manufacturing activities include the production of short life dairy products such as yoghurt and long life products such as butter, cheese and various milk powders. Distribution/vending activities include the distribution of fresh milk to wholesale and retail outlets.[60]

Historically, all States have regulated most aspects of the milk market, from production to final consumption. However, especially during the 1990s, State Government involvement in the processing, vending and retailing sectors was greatly diminished. Victoria, South Australia, Western Australia and Tasmania removed controls on most aspects of milk distribution and pricing beyond the farm gate, as did NSW on 1 July 1998 and Queensland on 31 December 1998.[61]

Prior to full dairy deregulation on 1 July 2000, the distinction between 'market milk' and 'manufacturing milk' was a key feature of the industry. Market milk was processed into fresh, drinking milk, whilst manufacturing milk was used in the production of dairy products. All milk produced in NSW was formally vested in the NSW Dairy Corporation, which controlled the annual supply of market milk through systems of individual milk production quotas. Farmers who held milk quota were required to deliver the designated quantity of

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59 Australian Catholic Social Welfare Commission, *National competition policy. Submission to the Productivity Commission Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia*, December 1998, at 41.

60 NSW Government, *Review of the NSW Dairy Industry Act 1979, Final Report*, NSW Government Review Group, November 1997, at 4.

61 NSW Government, *Review of the NSW Dairy Industry Act 1979, Final Report*, NSW Government Review Group, November 1997, at 18.

quota milk on each day or for each day of a particular period, in exchange for which they received a guaranteed price per litre. The capital value of milk quota, which was tradeable, was directly related to the extent to which producing quota milk led to higher farm profits. Given that milk quota traded at positive prices it is clear that owning quota did lead to higher farm profits compared with not owning quota.[62]

This is also evident when comparing the regulated farm gate price and the manufacturing milk price. In 1995-96 the market milk price paid in NSW was 52.9 cents per litre, whilst manufacturing milk price was 25.9 cents per litre. The prices paid in other States is shown below in Table 2. Manufacturing milk price varied in response to movements in the prices of dairy products on world markets.

Table 2: Farm Gate Market and Manufacturing Milk Prices, 1995-96, cents per litre[63]

	Manufacturing Milk	Market Milk
NSW	25.9	52.9
Victoria	27.5	50.1
Queensland	21.2	56.8
South Australia	19.1	52.8
Western Australia	18.3	52.0
Tasmania	24.3	53.3
Australia (weighted average)	26.3	51.7

For many years the Commonwealth Government provided support to the farm gate price of manufacturing milk during the 1980s and 1990s. In general, the level of support on a cents per litre basis declined during the 1990s, and concluded at 30 June 2000. Under the various Commonwealth schemes, annual payments were made to dairy farmers based on their production of manufacturing milk. The schemes did not control or regulate the supply of manufacturing milk, but had an impact on the production and manufacture of milk, resulting in industry rationalisation and efficiency gains. Funds for payment from the schemes were generated via a levy on milk used to produce manufactured dairy products on the domestic market and a separate levy on market milk. In 1999-2000, the payment to dairy farmers under the scheme was around 0.95 cents per litre of manufacturing milk.[64]

Under the auspices of fulfilling the NSW Government's commitment to the Competition Principles Agreement, a review of the NSW *Dairy Industry Act 1979* and its regulations was

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62 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 6.

63 NSW Government, *Review of the NSW Dairy Industry Act 1979, Final Report*, NSW Government Review Group, November 1997, at 19.

64 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 4.

carried out. The Terms of Reference for the review required an assessment of whether the public benefits of the legislation which established the NSW Dairy Corporation and the NSW Dairy Industry Conference (a peak advisory body) exceeded the costs and whether the legislative objectives could only be achieved by restricting competition.

In regards to price setting and management, the review body could not come to a consensus, with two conflicting recommendations made in this area. They were:

- The Chairman, Industry and Corporation members of the review group (the majority) recommended that the current pricing and supply management arrangements remain in place, and in accordance with NSW Government policy, be reviewed again by July 2003 (recommendation 2); whereas
- Government department members of the review group excluding the Chairman (the minority), recommended that:
  1. Regulated farm gate prices and supply management for market milk be removed, preferably in a coordinated way across states;
  2. In the absence of interstate coordination, the removal of regulated farm gate pricing and supply management arrangements should be achieved by giving 3-5 years notice, commencing in July 1998;
  3. The NSW Government support an industry application to the ACCC for authorisation of collective negotiation as a transitional measure following cessation of the current arrangements.[65]

In May 1998 the NSW Government announced that it had agreed to extend the regulated milk supply management and farm gate pricing arrangements for a further five years, until 2003. However, this was subject to two clauses, and enabled the Government to revisit the regulations before 2003 if the Federal Government withheld competition payments, or if market factors had an adverse impact on the industry's stability before 2003.

However, a similar competition review in Victoria led to the decision to totally deregulate the industry by 1 July 2000. It became apparent that the market forces in Victoria would make it difficult to maintain any form of regulated system in NSW after 1 July 2000. Indeed, ABARE described the transition to deregulation as 'inevitable'.[66]

To follow the development of government policy in regard to dairy deregulation it is worthwhile to reproduce Minutes from the ARMCANZ Ministerial Council – the Agriculture and Resource Management Council of Australia and New Zealand.

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65 NSW Government, *Review of the NSW Dairy Industry Act 1979, Final Report*, NSW Government Review Group, November 1997, at xiv.

66 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 2.

ARMCANZ Minutes Meeting No 15[67]

5. Given the size of the Victorian dairy industry and its lower cost production regime, the commercial sustainability of liquid milk arrangements in other States would be undermined by any decision to dismantle liquid milk arrangements in Victoria. The removal of these arrangements would allow Victorian milk to be sold interstate at prices closer to the manufacturing milk price plus a premium for assured supply and the costs of interstate transport.

6. The impact of deregulation on farm incomes in all States is potentially quite high. In States such as New South Wales, the loss of farm income through the removal of regulatory arrangements could be as high as $50,000 per farm. In Victoria, it is estimated that farmers will lose, on average, around $20,000 annually. While farmers would be able to offset their financial losses to some degree by adjusting the cost of their operations through more seasonal production, it is likely that the income losses of the magnitude anticipated would cause significant economic and social dislocation in regional and rural communities.

7. In anticipation of the removal of liquid milk arrangements in Victoria, the Australian dairy industry, led by Mr Pat Rowley (Chairman – Australian Dairy Industry Council) is attempting to develop a package which would assist farmers, financially, to manage the transition to a fully deregulated environment

8. While the details of the package have not been finalised, it is understood that dairy farmers would be paid a one-off up-front cash payment totalling $1.25 billion in return for the removal, from 1 July 2000, of all Commonwealth and State legislation underpinning milk pricing arrangements. The payments to farmers are to be funded by a commercial loan with the full cost of the loan repaid through a Commonwealth levy on liquid milk sales over a period of between five to ten years.

ARMCANZ Minutes Meeting No 16[68]

3. Following ARMCANZ consideration of competition reform of the dairy industry at its meeting on 5 March 1999, ADIC [Australian Dairy Industry Council] has developed a restructuring package. The ADIC proposal provides for $1.25 billion assistance package which would be used as payments to individual producers, in return for the dismantling, from 1 July 2000, of all Commonwealth and State legislation underpinning milk pricing arrangements.

4. Under the ADIC proposal, finance for the proposed package would be raised as a commercial loan, and be repaid through a levy on fresh milk sales. Issues such as the size and duration of the levy, taxation consideration and implementation arrangements were left to be finalised in consultation with the Commonwealth.

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67 Agriculture and Resource Management Council of Australia and New Zealand, *Resolution No 1A*, Meeting No 15, 5 March 1999.

68 Agriculture and Resource Management Council of Australia and New Zealand, *Resolution No 1H*, Meeting No 16, 6 August 1999.

5. The package is presented as finely-balanced to attain support from all State dairy farmer organisations and industry sectors.

6. Issues for the Commonwealth in considering the ADIC proposal include the need to ensure the dairy package facilitates adjustment towards increased international competitiveness while alleviating potential for industry dislocation through addressing the adverse impacts of deregulation at an individual and regional level. Another important consideration for the Commonwealth is ensuring the package meets Australia's international commitments within the WTO.

7. The Commonwealth has held a number of discussions with industry, and is currently preparing its formal response to the proposed package. However, the responses of the States and Territories to the package will be pivotal in finalising the Commonwealth's approach. An agreed national response will be an essential element in any package of measures that might be facilitated by the Commonwealth.

The key themes emerging from these ARMCANZ meetings, as evidenced from their Minutes, is the potential dire consequences for dairy farmers if deregulation went ahead (especially for those farmers outside Victoria), and the need for an agreed national response before the Commonwealth facilitated any assistance measures. Ultimately, a Commonwealth facilitated billion dollar Dairy Industry Adjustment Package was developed, which commenced on 1 July 2000.

The Dairy Industry Adjustment Package comprised three programs:

- Dairy Structural Adjustment Program – providing $1.63 billion in payments for eligible dairy producers, to be administered by the Dairy Adjustment Authority;

- Dairy Exit Program providing an optional tax-free exit payment of up to $45,000 for eligible dairy producers wishing to leave the industry, to be administered by Centrelink; and

- Dairy Regional Assistance Program – providing $45 million to assist regional communities to adjust to dairy deregulation, to be administered by the Department of Employment, Workplace Relations and Small Business.

Dairy Structural Adjustment Program payments are to be made quarterly over eight years and are based on a rate of 46.23 cents per litre on market milk and 8.96 cents per litre on manufacturing milk deliveries in 1998/99. The Dairy Structural Adjustment Program is funded through an 11 cents per litre levy on retail sales of market milk, which will operate for a period of approximately eight years.

On 20 May 2001 the Federal Agriculture Minister Hon Warren Truss MP announced an additional $140 million of federal assistance measures for dairy farmers and dairy communities who have been most affected by the deregulation of Australia's milk market.

The $140 million package included:[69]

- $100 million in supplementary market milk payments to dairy farmers who were most heavily dependent on market milk production;
- $20 million for eligible people who, because of extraordinary circumstances, were excluded, or their entitlements were significantly lower than normal, under the Government's Dairy Structural Adjustment Program (DSAP), and
- $20 million expansion of the Dairy Regional Assistance Program (Dairy RAP).

The deregulation of the dairy industry required legislative change. In NSW, after considerable debate in the Parliament, the passage of the *Dairy Industry Bill* finally went through all stages and was assented to on 29 August 2000. This led to the full deregulation of the NSW dairy industry on 1 July 2000, in tandem with the deregulation of the industry in other States.

4.1 The impact of deregulation on the dairy industry

To date, the most comprehensive review of the effects of dairy industry deregulation have been carried out by ABARE. This section of the paper draws largely from the ABARE work.

Since the introduction of an open market in milk on 1 July 2000 the average farm gate price of milk has fallen substantially in all States – as shown in Table 3 below. For example, in NSW the average farm gate price paid for milk is forecast to be around 25.4 cents a litre in 2000-01, compared with an average price of 36.0 cents a litre in 1999-2000.[70]

Table 3: Average farm gate milk prices, by State.[71]

	1999-2000 cents / litre	2000-2001 (projected) cents / litre	Change %
NSW	36.0	25.4	-29
Victoria	26.0	25.1	-3
Queensland	39.3	30.0	-24
South Australia	28.0	24.2	-14
Western Australia	36.0	25.0	-30
Tasmania	25.9	24.0	-7

69 Media Release "Truss announces an extra $140 million for dairy farmers and their communities" 20 May 2001, Dairy Adjustment Authority.

70 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 9.

71 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 9.

In NSW an estimated 200 dairy farms have left the industry in the six months between July and December 2000. This compares with a decline of 46 dairy farms for the full year between June 1999 and June 2000. ABARE expected the decline in dairy farm incomes in 2000-01 to be consistent with changes in the average farm gate price of milk. Thus the largest reductions in dairy farm incomes are expected in NSW, Queensland and Western Australia, followed by South Australia, Tasmania and Victoria. Assistance to dairy farmers under the Commonwealth Dairy Structural Adjustment Package (DSAP) will partly offset the impact of lower farm gate prices in 2000-2001. Dairy farmers in NSW are expected to receive DSAP annual payments of around $20,320 per farm, on average, made up of four quarterly payments. Over the next eight years this represents a total of $162,000 per farm. However, it is important to note that the payments will differ significantly from farm to farm as they are directly related to each eligible farm's production of market and manufacturing milk in 1998-99. In addition, the payments are divided between partners, sharefarmers, lessees and lessors such as the aggregate payments may not necessarily accrue to the current operators of the farm.[72]

ABARE noted that for the majority of farmers in Victoria and Tasmania, the sum of farm cash income and their DSAP payments in 2000-01 is likely to exceed their average farm cash income in 1999-2000. In contrast, in NSW, Queensland and Western Australia, the forecast reduction in average farm income in 2000-01 is likely to exceed the average DSAP payment. However, some of these farmers may be better off as their DSAP payment is expected to more than offset the reduction in farm income from milk.[73]

The impact of the open milk market is apparent both in retail prices and products. Non-branded products and supermarket brands are becoming more prevalent and competing strongly for market share, which is pushing the price for branded milk down. ABARE noted that an ACCC milk price survey, which indicated that since deregulation the 'spot' price of mostly branded milk product per litre has dropped from $1.32 to $1.29 per litre in NSW. ABARE also noted anecdotal evidence that price discounting among other milk package sizes, principally two and three litre packages, implies a significant reduction in the average retail price of milk since the introduction of an open milk market.[74]

ABARE noted that over the medium to long term there may be further changes to farm gate milk prices. As long as Australia remains a major exporter of dairy products, returns in the fluid milk sector will ultimately be strongly related to returns for Australian dairy products on world markets. ABARE concluded that as long as dairy farmers in NSW, Western

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72 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 19.

73 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 19.

74 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 20.

Australia and Queensland continue to produce significant quantities of 'manufacturing milk', the prospect of farm gate prices being significantly above export parity is unlikely.

One of the major problems of farm gate prices being correlated to export prices is that the world market for dairy products has been described as extremely corrupted. The major markets for Australia's dairy products are tightly controlled and will continue to have significant import restrictions and tariffs well into the next negotiating round of the World Trade Organisation post 2004. While import barriers are a major impediment to the Australian dairy industry widening its export base, the greatest impediment to growth is the low level of world market prices which are essentially set by European export subsidies.[75]

The move to an open milk market from 1 July 2000 resulted in a reduction in the transfer of income from consumers of dairy products to dairy farmers. The reduction in aggregate transfers to dairy farmers for 2000-01 was estimated to be $170 million. This was estimated by ABARE as the net effect of reduced market milk premiums, cessation of market support schemes, and the introduction of DSAP payments. The extent to which regional or local economies are affected by the move to an open market in milk depends on a number of factors, including:

- The aggregate reduction in dairy farm incomes in a region; and
- The overall dependence of the regional economy on the dairy industry.

ABARE used two indicators as a proxy for these two factors. The proxy used for the likely decline in the incomes of dairy farmers was the ratio of market milk production to total milk production in the region prior to 1 July 2000. This ratio indicates the extent to which farmers relied on market milk premiums to derive their income. The higher the ratio the greater the likely adjustment pressures. The proxy used for the overall dependence of the regional economy on dairy farming was the proportion of people in the region employed on dairy farms. The higher this ratio the greater the potential for the regional economy to be significantly affected by the move to an open milk market.

ABARE then ranked regional statistical local areas according to the above two proxy indicators. ABARE noted that the analysis was intended to be used as a guide to potential regional adjustment, and was not intended to identify all regions that are suffering from adjustment pressure, or to definitively rank the level or extent of pressure in each region.

As shown in table 4 below, regions in NSW that were rated as having high on farm adjustment costs combined with high regional dependence on dairy farming were Dungog and Gloucester. Other regions for NSW and their rating are also listed in table 4.

75 NSW Government, *Review of the NSW Dairy Industry Act 1979, Final Report*, NSW Government Review Group, November 1997, at 16.

Table 4: Regional impacts of an open milk market[76]

Statistical local area	Average on-farm impact	Regional dependence on dairy sector	Number of dairy farms in SLA (as at March 1997)
Dungog	High	High	95
Gloucestor	High	High	72
Muswellbrook	High	Medium	56
Greater Taree	High	Medium	205
Singleton	High	Medium	79
Bellingen	High	Medium	62
Bega Valley	High	Medium	130
Great Lakes	High	Low	20
Eurobodalla	High	Low	28
Copmanhurst	High	Low	5
Nambucca	High	Low	26
Nymboida	High	Low	4
Forbes	High	Low	10
Hastings	High	Low	108
Ulmarra	High	Low	11
Kempsey	High	Low	49
Kiama	High	Low	49
Manilla	High	Low	5
Scone	High	Low	42
Berrigan	Medium	High	69
Kyogle	Medium	High	86
Conargo	Medium	High	49
Tumbarumba	Medium	Medium	19
Richmond River	Medium	Medium	45
Wakool	Medium	Medium	37
Wingecarribee	Medium	Low	56
Shoalhaven	Medium	Low	101
Murray	Medium	Low	16

76 Australian Bureau of Agricultural and Resource Economists, *The Australian Dairy Industry, Impact of an Open Market in Fluid Milk Supply*. ABARE report to the Federal Minister for Agriculture, Fisheries and Forestry, January 2001, at 29.

4.2 The New South Wales Government response to dairy deregulation

In partnership with the dairy industry, the NSW Government established the 'Dairy Do It' initiative, which is comprised of three projects: Dairy Assist; Dairy Check; and Dairy Family.

Dairy Assist provides information and assistance to eligible dairy farmers applying for payments under the DSAP. Dairy Check assists dairy farmers to analyse the current performance of their farm business, examines management alternatives and make informed decisions about options to maintain or improve farm profit. Dairy Family supports dairy families adjusting to change through: enhancing the capacity of the Rural Financial Counsellors; developing a network of DairyFamily coordinators who develop local directories of service providers; and facilitating introduction of dairy farm families to appropriate counselling services.[77]

In addition to these programs, some $500,000 has been allocated to the NSW Dairy Industry Transition Initiative. This is managed through the Department of State and Regional Development, under the Regional Economic Transition Scheme. The Initiative can provide assistance for the establishment of new industries that can provide job opportunities in dairy communities, business training for people exiting the industry, and examination of further value adding opportunities for milk products.[78]

In response to concerns about the effects of dairy deregulation, the State Government also established the Dairy Deregulation Impact and Assessment Committee. The Committee is to examine, report and make recommendations to Parliament on the financial impacts on the New South Wales dairy industry following deregulation. The Committee will consider the impact of deregulation for the period July 2000 to June 2001, and provide a final report to the Minister for Agriculture by 31 October 2001.

The Committee released an interim report in March 2001. The Committee noted that in public forums it had organised, the overwhelming sentiment expressed by dairy farmers was the need to increase the price they received for their farm milk in order for them to remain viable.[79]

The Committee also noted that at their public forums, New South Wales dairy farmers have called for compensation for the loss of milk quotas brought about the by the introduction of deregulation. The farmers have raised the issue that the National Competition Policy payments made by the Commonwealth to the States could be used for this purpose. The Committee noted that the State governments are free to spend these payments as they see appropriate, and that the New South Wales Government has obtained legal advice that it is

77 NSW Agriculture, *Dairy Farmers: Guide to assistance available in NSW*. Agnote DAI-228, February 2001, at 2.

78 NSW Agriculture, *Dairy Farmers: Guide to assistance available in NSW*. Agnote DAI-228, February 2001, at 3.

79 Dairy Deregulation Impact and Assessment Committee, *Interim Report*, March 2001, at 5.

not liable for quota compensation payments.

The Committee also considered the issue that the Commonwealth DSAP payments to dairy farmers are fully taxable as income. The Federal Government could receive around $380 million nationally from the $1.6 billion adjustment package. Dairy farmers have expressed their concerns at the effects of losing up to one third of their payments to income tax, thereby stifling their ability to effectively use the package. The Committee noted that professional advice to the Federal Government indicated that this taxation would be revenue neutral to the Government but not to the recipients. Hence the Committee recommended calling on the Federal Government to immediately examine the dairy structural adjustment program with a view to providing income tax relief.[80]

The Committee also heard that DSAP payments received, whether over eight years or as a lump sum up-front payment, are treated as income for the eight year period for payments made by Centrelink for such items as family tax benefits, parenting payment and pensions. It is estimated that in NSW, as many as 80-90 percent of dairy farmers have opted to convert their DSAP payment to the up-front facility, primarily to reduce farm debt or acquire productivity generating assets. Many farmers, some of them elderly and wishing to retire from the industry, are now in the position where they are ineligible or significantly disadvantaged in receiving any of the above mentioned Centrelink payments because they are deemed to still earning the DSAP payments as income and will be assessed accordingly for the next eight years.

The Committee recommended that representations should be made to the appropriate Federal Government Ministers with the aim of obtaining relief for dairy farmers who need social security entitlements but are disadvantaged through the assessment of DSAP payments as income for the eight years.[81]

Amongst other recommendations, the Committee also recommended that an approach be made to the NSW Government with the aim of establishing a mechanism to make available to NSW dairy farmers reduced interest rate loans for prescribed farm development. Examples of this development may include capital expenditure to improve productivity, maintenance and replacement of farm equipment and costs for meeting environmental standards.

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80 Dairy Deregulation Impact and Assessment Committee, *Interim Report*, March 2001, at 6.

81 Dairy Deregulation Impact and Assessment Committee, *Interim Report*, March 2001, at 6.

5.0 CONCLUSION

The National Competition Council has noted that between 1960 and 1992, Australia went from being the third richest OECD nation to being only the fifteenth. The Council claims that the declining performance of our economy was largely due to the protection from competition of large sectors of the economy. Protected businesses had little incentive to reduce costs and prices, produce new, innovative products and use resources as efficiently as possible.[82]

The Council also noted that the economic pressures that drove the development of the NCP program have not gone away and the recent Asian financial crisis has re-emphasised the importance of having a flexible, internationally competitive economy. By working to ensure that conditions for competition prevail, the Council argues Governments will promote growth, innovation and productivity helping to raise the living standards of the Australian community.

Other commentators also argue that whilst it is recognised that some people and communities in rural Australia are 'doing it hard', rural Australia is doing much better than many commentators assert. For instance, commodity prices have improved and the lower Australian dollar is set to make rural exports even more attractive. In addition, the reform of rural industries has put them in an excellent position to compete internationally.[83]

In regards to the dairy industry, it is also apparent that some of the DSAP payments are having a positive impact. For instance, Bega Cheese was successful in applying for a $660,000 Dairy Regional Assistance Program grant, to purchase and install a new shredded cheese line. The funding allowed the cheese manufacturer to enter the new business years ahead of when it may have done so otherwise, and created immediate economic activity by way of jobs creation and entry into new markets. Bega Cheese noted that if its own successful outcome of this grant scheme can be repeated around the country with the $45 million allocated to the program, then it would result in 1400 jobs and sales of $1 billion.[84]

It is evident throughout this Paper that national competition policy, and micro-economic reform more generally, have created both winners and losers. One of the major problems is that, whilst the benefits of NCP are generally longer-term and spread more widely amongst the community, the costs of change are often concentrated in a particular area and borne immediately. Ultimately, how society compensates and supports those affected by NCP reforms is a key issue yet to be satisfactorily resolved.

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82 See the National Competition Council Website: www.ncc.gov.au.

83 Skeffington,R. "The Myth of 'Two Australias'. Wealth and Income Distribution". *Policy*, Summer 2000-2001, at 18.

84 Van Ryan,M. "Making the most of markets." in *Outlook 2001. Capturing Growth Opportunities, Agriculture and Regional Australia*, Vol 2. Proceedings of the National Outlook Conference, Canberra 27 February – 1 March 2001, at 301.