COMPETITIVE NEUTRALITY AND ACCESS TO GOVERNMENT BUSINESS ENTERPRISES: CAN ONE HAVE TOO MUCH OF A GOOD THING?

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Introduction

The National Competition Policy is, amongst other things, a response to the problems of monopoly. By competition policy I mean not only the imposition of rules of access and prices surveillance on infrastructure of national significance, but also the associated reform of Government Business Enterprises (GBEs) so that they facilitate the emergence of competitive national markets.

The motivating vision of national competition policy comprehends a few basic principles. Speaking historically the first element of the national competition policy began as GBE reform in the late 1980s. Under the national competition policy, that process has matured into a thoroughgoing commitment to competitive neutrality between private enterprises and GBEs. In the context of this commitment artificial barriers to competition are being systematically stripped away. And where competition might be stifled by the technical preconditions of monopoly - economies of scale and sunk costs - a range of interventions are designed to maximise competition.

Some of the main principles of GBE reform and the NCP are as follows:

1. Where a GBE has both regulatory and trading functions, regulatory and trading functions should be separated.
2. Statutory barriers to competition against GBE should be dismantled.
3. Institutional arrangements should strive to make GBEs competitively neutral with competitors. Thus for instance arrangements should be made to remove tax exemptions from GBEs.
4. Issues of efficiency and equity should be clearly delineated. Thus activities, which are effectively subsidised by the GBE, should be identified as community service obligations and (ideally) funded from taxation revenue.
5. Board members of the GBE should not be chosen for political reasons or to represent community interests. They should be selected for their ability to contribute to the GBE's commercial success.
6. The GBE should be given substantial independence from government. Steps should be taken to minimise or eliminate the extent to which governments of the day can direct them in their commercial conduct.
7. GBE management should be given commercial objectives. It should be encouraged to increase returns on funds employed to the business.

One of the deliberate consequences of such reform is that as a GBE moves down the path to reform, privatisation makes progressively more sense. The ideal here is competitive neutrality in which ownership is largely irrelevant.

The Proposal

I have no quibble with this agenda. I endorse it. My concern is not to resist the tide of privatisation – if we can't think of any good reasons not to privatise a GBE then we should privatise it.

Yet there does seem to me to be a perspective which has got a little short shrift in the National Competition Policy. Competitive neutrality is a virtue, but so too are other things. Rather than make it an absolute standard, it seems to me that it is a desirable objective, which should occasionally yield to other desirable objectives. This is particularly the case where – as in what I am about to propose – the deviation from competitive neutrality is not at the expense of private firms but rather to their advantage.

Where GBEs have some market power there remains the problem of monopolistic pricing and restrictive behaviour – by which I mean the GBE's refusal of third party access to its facilities and services. Of course competition policy has a standard response to this dilemma. Prices surveillance exists to curb monopoly power and access regimes can be imposed to limit the scope for restrictive behaviour.

This approach is valuable. But we may be able to do better.

Under existing competition policy reform, solutions to the problem of monopoly are imposed – from without as it were – on firms with sufficient market power to warrant it. Of course the moment one moves away from the production of agricultural commodities the economy is riddled with imperfections in competition. But the national competition policy is reticent to impose external constraints on firms because these actions cut across a fundamental principle of our economy – freedom of contract between private agents.

So we don't impose public constraints on those with market power unless certain threshold tests are passed. In the national access arrangements, before compulsory access arrangements are invoked, we require a range of tests to be met including:

- That the asset is of national significance,
- that providing access will increase competition and
- that access will not be contrary to the public interest.

Of course this is second best. We would like to see less monopolistic and restrictive behaviour than we do even where these tests cannot be passed. But the judgement is made, I think rightly, that we impose competition policy only where we are confident its benefits (in reducing the economic costs of monopoly) outweigh its costs (attenuating freedom of contract and increasing business uncertainty).

But why should we be so reticent in requiring business enterprises, which are fully publicly owned, to act in a way which is not monopolistic or restrictive?

What I have in mind is that a rider be imposed on the overriding objective we give to managers of wholly publicly owned GBEs. They would be charged with the task of maximising returns on funds subject to the additional condition that they not engage in monopolistic pricing or restrictive behaviour.

It would not be consistent with these instructions for managers to charge monopolistic prices and then dissipate the rents with technical inefficiency (including featherbedding of the workforce). Indeed the objective of maximising shareholder value requires the optimisation of technical efficiency but this would have to be maximised subject to the constraint that it be achieved without resort to monopolistic pricing or restrictive behaviour.

Put another way, wherever a GBE faces a conflict between commercial objectives (its own self-interest) and being competitive (including providing competitors and potential competitors with access to its facilities) [2] competitive rather than commercial objectives should dominate. For the sake of convenience I will call this 'extended access' to distinguish it from the existing access arrangements which apply by virtue of the National Competition Policy.

I might add at this point that this paper sketches my proposal with a relatively broad brush. There are plenty of 'i's which are not dotted and 't's not crossed. I am not trying to suggest that my proposal be applied automatically without thought in particular situations. There may be circumstances where it is not appropriate to provide access to a wholly owned GBE. For instance the national competition policy itself proposes that access should not be granted if it would be unsafe in some way and obviously this should remain the case notwithstanding my arguments here. The central point I would make is that where we see it as legitimate for a privately owned enterprise to resist access if it considers this would be inimical to its owners value, we should regard such reasoning as inherently suspect in the case of wholly publicly

[2] At prices which provide an appropriate commercial return on funds.

owned firms. The managers of those firms should be encouraged to maximise shareholder value, but not where in so doing they reduce by a greater amount the community's economic welfare. Economic theory would lead us to suspect that this will generally (though I concede not necessarily always) be the case where a firm prices monopolistically or resists third party access to its facilities.

Examples

Where should my proposal for extended access apply?

I will argue below that it could have made an important contribution to economic welfare in the last ten years. But looking forward, the most obvious candidate is Australia Post. The Industry Commission recommended in 1992 that interconnection be allowed under fair terms and conditions and arrangements now exist to realise that recommendation. In fact a rather incomplete access regime has been imposed which applies only to certain situations. The National Competition Policy does not apply. Extended access would improve economic welfare.

Likewise even after the last ten years there remain a wide range of GBEs which remain fully publicly owned in industries such as gas and electricity and rail. Extended access seems worthwhile in all these areas.

Some Counterfactuals from the Recent Past

What might have happened if extended access arrangements applied to fully publicly owned GBEs in the 1980s. I think those GBEs could have usefully complemented the microeconomic reform which took place during that decade. The most obvious example is what was then called Australian Airlines. I recall Compass Airlines seeking terminal access and having to fight very hard for what they got. It was natural for Ansett to behave this way, but why did government policy permit Australian Airlines to do the same? The Industry Commission inclines to the view that airline terminal facilities should not have access imposed upon them by the National Competition Policy. But this has been argued in the context of what was once Australian Airlines being now held in private hands. Whatever the merits of the Commission's position on this matter, it is founded in considerations of the costs of *external* intervention with commercial decisions. Under my proposals, for so long as it remained fully publicly owned, there would have been no external intervention with Australian Airlines – unless it failed to meet its shareholder's objectives of granting fair commercial access to all its facilities.

Similar considerations apply to the Government's use of the Commonwealth Bank (for the period of time during which it was wholly publicly owned). It was difficult for

Banks to enter the Australian market without access to Australian bank networks. The Commonwealth Bank could have facilitated that access – on fair commercial terms including a commercial return on the funds employed. Had the Bank set about such a strategy it may well have depressed its own profits. But it would have accelerated the delivery of the benefits of deregulation to the rest of the community.

Possible objections

There are various possible objections to the proposals advocated here.

Probably the most substantial of the problems my proposal must encounter is the principal agent problem. It is one thing to tell managers to do something and another thing to get them to do it. Of course this problem is hardly unique to the issues I have raised. It looms large in virtually all areas relating to the management of large firms both public and private.

I have proposed imposing an additional constraint on GBEs and the legitimate question arises as to how one would ensure that constraint was actually accepted by management. To this there can be two responses. The first is the generic one that one would make the management of GBEs accountable for their performance in meeting this constraint in the same way and using the same tools of supervision that one uses to supervise equity investment in the first place. Certainly if one values more than simple profitability then it might be sensible to ensure that any incentive payments provided to management are not purely reflective of profit. Incentives based on cost reductions for instance - also not uncommon to the private sector - might make more sense than incentives based on purely on profits [3] although I am seeking to be suggestive rather than definitive here.

But there are also additional instruments that can be brought conveniently to bear. The National Competition Policy itself provides institutions capable of providing some supervision. With extended access, the granting of third party access to a GBE on terms less generous to the GBE than those it sought in commercial negotiation would reflect poorly on the GBE's management. The GBE should have provided access that was at least as advantageous as that which ultimately needed to be imposed by external institutions. In addition, it would be straightforward to amend the Trade Practices Act to lower the threshold tests for access to wholly publicly owned GBEs.

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[3] Of course if one based incentives on cost reductions one would also want to ensure that this did not occur by way of inappropriate reductions in service quality.

The extreme form of the 'principal-agent' argument is that GBE managers will do whatever they want regardless of the instructions they receive; that the government should save its breath in giving the GBE managers instructions and give them instead to their supervisors in this matter - the NCC and ACCC and ultimately the courts via the access regime. This may be right, but I would prefer to give the instructions to the managers in the first instance. If the GBE's management carries them out they will be carried out at lower cost than if they had to be imposed via another organisation complete with the legal paraphernalia which inevitably accompanies the imposition of access. In many circumstances and certainly early in the piece it may be necessary to impose strong external disciplines to ensure that the policy is put into effect. But the usual arguments apply for self-administration subject to external audit. It is even possible that some GBE managers might take pleasure in their role in maximising competition and using this to drive efficiency in their own organisation at the same time as the economy more widely.

There are other objections.

There may be circumstances in which it is socially beneficial for firms to restrict access to their services. Given the utility services that GBEs provide, it seems to me unlikely that restrictive practices would be justified in many, if indeed any circumstances. But I am not seeking to prejudge this issue. It may be appropriate in some circumstances, for instance to manage commercial risks with other private sector partners in some new venture for a period of time. However there should be some rationale for engaging in restrictive practices which extends beyond the GBE's convenience.

A further objection is what I call the 'you can't walk and chew gum' objection. The argument goes that my proposal is setting the clock back to the bad old days in which GBEs managers were faced with multiple and conflicting objectives. I admit that my way of characterising the argument is a little unfair. There *is* merit in simplicity in these matters. But on the other hand management is all about managing subject to constraints. Whilst they pursue shareholder value, managers are expected to meet the constraints imposed by the law of the land. They must satisfy taxation, company law occupational health, safety, environmental and anti-discrimination requirements to name just a few.

Ultimately it seems to me that the 'you can't walk and chew gum' objection rests on a misunderstanding. The misunderstanding is that what is being proposed is a new community service obligation (CSO) of some kind. This would be the case if the proposal were for *subsidised* access or for access to some privileged class within the

economy. But CSOs typically relate to equity concerns. My proposal here is principally related to economic efficiency not equity although it does have the advantage that it should generally promote equity.

Another objection I have heard raised is that we may want to privatise the GBE at some later stage and accordingly it would be inappropriate to run it differently to a private organisation. This is a reasonable argument but one which should be treated on its merits. Clearly if privatisation is to take place very soon there is little point in pursuing extended access requirements. But if privatisation is some time away there may well be efficiency gains in pursuing extended access. In the counterfactuals explored above it seems likely that had extended access been pursued with GBEs which have subsequently been privatised, high prices might have been squeezed out of markets which were being deregulated much sooner than they have been.

Extending the model

One could extend this model into government from the world of GBEs. Whilst government engages in a range of activities which are not amenable to providing full access to the public – for instance policy advice to ministers of state much of which will remain confidential – many ancillary functions might be amenable to the granting of access.

Let me take an example that is apposite in the company in which I find myself. The ACCC has a library. I used to enjoy the services of the Industry Commission's library. However I no longer work there. Now that I am at the BCA it might be the most cost-effective arrangement for me to use the ACCC's library. Now I'm not suggesting that I should have subsidised access to the library – any access I have should be fully costed including an appropriate return on investment. And I should pay for any special arrangements that need to be made. And if there is no spare capacity, the Commission should be permitted to prevent my entry, as its statutory duties should presumably come first. There might be other legitimate reasons why I should not be granted access. I might be a disreputable person who could not be trusted to return books. The point I am making is that the only reason the Commission should *not* grant me access is that it would be easier for it if it didn't consider the issue, or that it is not its business.

Here one might build a case for freedom of access to public assets in a way that is analogous to the case for freedom of information within government organisations. There should be a presumption of access, which is rebutted where there is a good case not to grant it. At present the reverse is the case.

I use the example merely for illustration, not because I am planning any fights for access to Professor Fels' library – or indeed expect that a request for access at a reasonable price would not be considered sympathetically.

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