Assessment Against the Competition Test

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McKell Building
2-24 Rawson Place, SYDNEY NSW 2000

Email: better-regulation@finance.nsw.gov.au
Website: www.finance.nsw.gov.au/better-regulation

First published by the Department of Premier & Cabinet in April 2008.

The Guide to Better Regulation and supplementary documents are the subject of an independent review of the NSW regulatory policy framework, which was announced by the NSW Government in August 2016. The requirements set out in this document continue to apply while this review is underway, and have been updated to reflect recent changes. It is expected that this interim version will be revised again following the completion of the independent review in 2017.

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1. Introduction

The NSW Government's Better Regulation requirements commenced on 1 June 2008. Those requirements are set out in the Guide to Better Regulation (the Guide). The Guide assists agencies to develop regulation which is required, reasonable and responsive to the economic, social, and environmental needs of NSW. The Guide provides details on how to apply the seven better regulation principles when designing and developing regulatory proposals.

The Guide was updated in October 2016 to reflect the changes in the roles and responsibilities of the NSW Department of Premier and Cabinet (DPC) and the Better Regulation Division (BRD) in the NSW Department of Finance, Services and Innovation (DFSI) for maintaining and monitoring compliance with the Guide. The Guide also incorporates the NSW Government's Licensing Framework requirements for proposals that introduce or amend a licence.

The Guide and supplementary documents are available on the Better Regulation webpage on the DFSI website: www.finance.nsw.gov.au/better-regulation.

This document accompanies the Guide by providing more detailed information on how to assess a regulatory proposal against the competition test described in the Competition Principles Agreement (1995).

BRD is available to provide agencies with assistance and advice. Agencies working on significant regulatory proposals should consider approaching BRD early in the development process.

BRD can be contacted at:

Email:	better-regulation@finance.nsw.gov.au
Website:	www.finance.nsw.gov.au/better-regulation
Address:	McKell Building 2-24 Rawson Place SYDNEY NSW 2000

2. Restrictions on competition

Competition is characterised by independent rivalry between businesses. The benefits of competition include increased efficiency, innovation, reduced prices and greater consumer choice.

In most cases, competition without restrictions will allow the most efficient allocation of resources for the benefit of the whole community. However, in some cases, a competitive market may not provide the best economic or social outcome or alternatively, the conditions are not always present for competition to thrive. In such circumstances, governments may need to regulate to address these market failures. However, such regulation imposes costs.

Through ensuring that competition is restricted only where necessary, unnecessary costs to the business and the broader economy can be reduced.

In the interest of promoting competition the NSW Government, along with other Australian Governments, committed to the following principles under clause 5 of the *Competition Principles Agreement*:

Legislation should not restrict competition unless it can be demonstrated that:

- *the benefits of the restriction to the community as a whole outweigh the costs; and*
- *the objectives of the legislation can only be achieved by restricting competition.*

The exercise of assessing existing or proposed regulation against these principles is referred to as the 'competition test'.

3. When to conduct a competition test?

Any regulatory proposal (or existing regulation) that would impose a material restriction on competition should be assessed against the competition test. This will not necessarily be required of every regulatory proposal.

There are a number of different categories of restrictions on competition and many examples within each category.

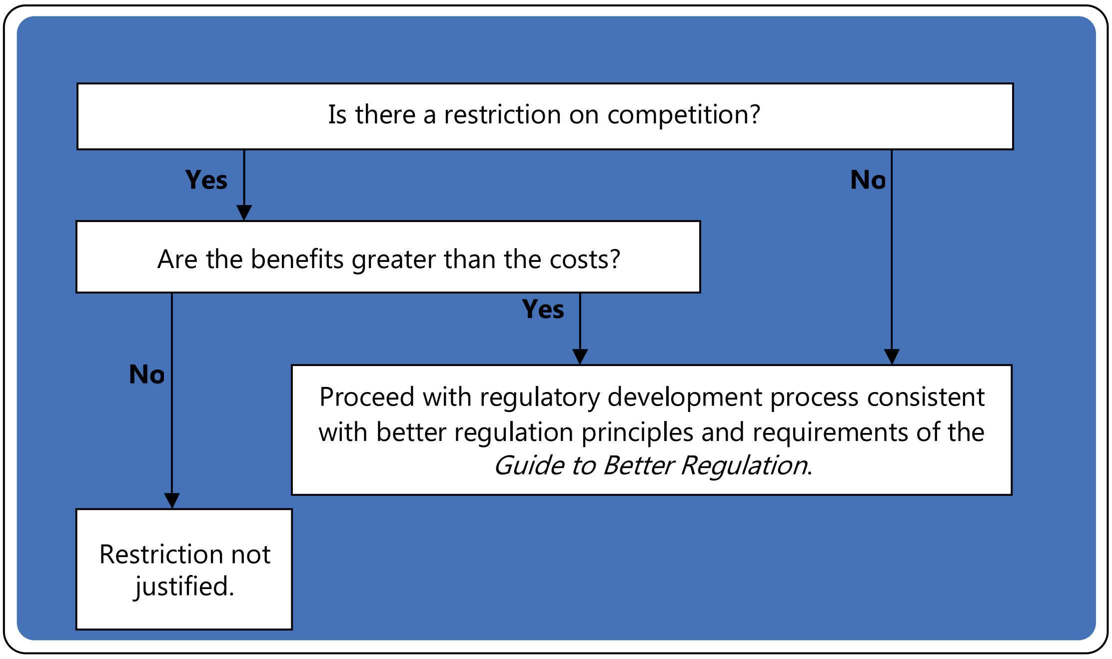
The following table sets out some of the main categories of restrictions on competition, and some examples of the types of regulatory arrangements that impose those restrictions. Some regulatory arrangements may impose more than one restriction, and some restrictions may fall into more than one category.

Category of restriction	Examples
Barriers to entry or exit	• Creates or protects a single buyer or seller. • Limits the number of firms that can carry out a particular activity. • Restricts who can own or operate a business. • Gives existing firms access to information that is not available to new market participants.
Conduct Restrictions	• Controls prices or production levels. • Restricts certain activities, for example, advertising. • Imposes requirements on product quality. • Restricts the level, location or time availability of goods or services. • Restricts access to inputs used in the production process, for example, infrastructure and employment standards. • Limits consumer access to particular goods or services.
Increase in business costs	• Imposes specific levies and/or imposts on a particular industry. • Imposes high administrative or compliance costs.
Advantage for some firms over others	• Imposes requirements on certain firms, but not on competing firms. • Advantages government businesses over the private sector. • Gives one firm access to infrastructure, but not others.

4. How to conduct a competition test?

The competition test is based on the assumption that competitive market outcomes maximise public benefit. Accordingly, there is a presumption against regulatory intervention in markets.

The onus is on the proponent of a regulatory intervention to both demonstrate that the benefits of intervention outweigh the costs of restricting competition, and that there is no better means of achieving the objective.



As highlighted in the Guide, it is important to keep the principle of proportionality in mind when conducting a competition test. The greater the impact of the proposal, the more detailed the analysis will need to be.

The following are the key steps in conducting a competition test:

i. Describe the context

Describe the industry

This section should identify the existing industry participants and products or services they produce, current issues or trends facing the industry, and provide an assessment of the significance of the market to the economy as a whole (considering factors such as employment, linkages and size). This section should also discuss whether there are other markets that are or would be affected by the regulatory arrangements.

Describe the existing regulatory arrangements for the industry

A general discussion of the nature and features of the regulatory framework (for example, licences, restrictions to entry and quotas) is also necessary in conducting a competition test. Information on how the regulation compares to those in other jurisdictions would also be useful.

Identify affected stakeholders

For a restriction on competition to be justified, there must be a demonstration of a net benefit to the community as a whole. For this reason, it is important to identify all the stakeholders that are both directly and indirectly impacted by the restriction on competition. These stakeholders may include businesses, community groups and broader categories of stakeholders, such as consumers.

Describe the problem being addressed

This section needs to describe and provide evidence of the problem being addressed by the regulation, as well as explain how restricting competition is necessary to achieve the government's objectives. The problem should be described in terms of an identified market failure, such as externalities, asymmetric information, or market power. Detailed information on identifying the type of market failure can be found in Appendix A of the Guide.

In addition to describing the problem, there is a need to quantify the costs of the problem as far as practical. This is an important element of the competition test because it provides decision makers with an idea of the costs that are avoided by restricting competition and therefore provides a proxy for the magnitude of the benefits from restricting competition.

ii. Identify the restriction and its impacts

Identify the Restriction on Competition

Decision makers will need to clearly understand the type of competition restriction that is being assessed. Depending on the type of restriction, there may be different expected impacts.

The type of competition restrictions (for example, barriers to entry or exit, conduct restrictions, or discrimination between market participants) should be detailed in this section.

Describe the impacts of the restriction

Information on the effects of a competition restriction on businesses, consumers and the broader economy will assist decision makers to better understand the merits or otherwise of the restriction. This analysis should essentially focus on presenting the advantages and disadvantages of the restriction on competition.

For example, barriers to entry which encourage natural monopolies provide the advantage of encouraging economies of scale, but have the disadvantage of limiting innovation and product differentiation. Conduct restrictions may reduce externalities or exploitation of a resource but may have the disadvantage of limiting innovation or economies of scale.

In discussing the effects of the restriction, it is important to discuss the magnitude of these impacts. While quantification of impacts is preferred, in some cases qualitative assessments may be more appropriate, especially when detailing costs such as lower levels of consumer choice or reduced innovation.

iii. Assess the costs and benefits of the restriction

Assess the impacts in terms of costs and benefits

Information on the costs and benefits of a restriction on competition is essential for decision makers to assess whether the restriction may be warranted or not. Although not always possible, costings in dollar terms are preferable and should consider economic, social, environmental, public health and consumer safety costs and benefits. More information on assessing costs and benefits can be found in the Guide and the costing tool *Measuring the Costs of Regulation*. These documents are available on the Better Regulation website.

As a first step, it is important to recognise the different market participants and other stakeholders that are either directly or indirectly affected by the restriction on competition.

The costs of the restriction on competition may include changes to consumer prices as a result of changes to production costs or a lack of competitive pressure. Costs may also result from externalities or from a lack of choice or information that the community may have otherwise had access to. There may also be significant costs to Government from administering and enforcing the restriction on competition. Finally, costs to business may include restrictions on the types or quantity of inputs or outputs and an inability to achieve economies of scale or another more efficient business structure.

The benefits of a restriction on competition are similarly varied and may include a reduction in the risk of goods or services of inferior quality being available and/or decreases in the risk of illness and injury to members of the community. Other benefits may include incentives to increase product quality as a result of the competition restriction.

Again, while assessment of impacts in dollar terms is preferred, it is important to recognise that many of the benefits of regulation are intangible or non-financial, and should be assessed qualitatively.

Demonstrate that the benefits outweigh the costs

This section should demonstrate that the benefits of the restriction on competition outweigh the costs. There are several approaches which may be used to establish that there are net benefits from the restriction on competition.

For some assessments of costs and benefits, it may be possible to provide quantification in dollar values for all the most important costs and benefits. Because both the costs and benefits are presented in comparable terms, this is one of the easiest methods by which to establish that there are net benefits. In conducting this type of assessment, it is essential to ensure that all assumptions are clearly stated and are supported by as much evidence as possible.

Consultation with affected stakeholders will provide useful information on the scale of and types of costs and benefits that may result from a restriction on competition.

If quantification of all major costs and benefits is not possible, an alternative approach may be to list and rank all the costs and benefits (in both quantitative and qualitative terms) and reach an appropriate verdict on the net benefits. It will be useful to highlight how widely the costs and benefits are spread and identify which groups in the community are affected.

Another practical approach, in cases where the costs and benefits cannot be quantified, may be to assess the risks to the population in the absence of the restriction on competition. If the risks are found to be unacceptable, it may be possible to infer that the benefits outweigh the costs. The next step would then be to ensure that the lowest cost means of dealing with the risk are employed.

iv. Consider alternatives to restricting competition

Having established that the restriction on competition provides a net benefit, the final step is to demonstrate that there are no alternative means of achieving the objectives that do not restrict competition or are less restrictive.

There needs to be an assessment of whether the market failure could be addressed in some other way that does not restrict competition. For example, consideration should be given to whether existing laws (trade practices legislation, planning and environmental laws, consumer protection legislation) may be sufficient to deal with the problem. Alternatively, there could be market initiated responses that could adequately deal with the problem such as voluntary standards, insurance schemes, or the provision of information by consumer associations.

Other government actions that should be considered as alternatives to restricting competition include persuasion and information disclosure (particularly where information asymmetry is the market failure being addressed), financial incentives (particularly for externalities), or regulations and laws with a less restrictive design (particularly for market power).

In discussing any alternatives to a competition restriction, it will be important to consider the benefits and costs of the option.

An outline of some alternative options to assess when considering a restriction on competition is presented in Appendix A.

5. The competition test and the Better Regulation requirements

It is necessary to conduct an assessment against the competition test on any proposed regulation that would impose a material restriction on competition. If required, the test should be undertaken as part of the regulatory development process outlined in the Guide.

The outcomes of the competition test will need to be referred to when demonstrating compliance with the Better Regulation principles in accordance with the Guide.

A more comprehensive written record of the competition test should be maintained as a demonstration of compliance with the NSW Government's obligations under the *Competition Principles Agreement*. The Minister for Innovation and Better Regulation or the BRD may request a copy of the test in order to assess compliance with the requirements.

Consistent with the Guide, it will be essential to monitor and review the restriction on competition to ensure that there is still a need for the restriction over time.

Appendix A: Some Options for Addressing Market Problems

Reason for Competition Restriction	Options for consideration
Natural Monopoly	• Remove barriers to substitutes. • Increase exposure to international competition. • Access regulations.
Market Power	• Introduce laws on anti-competitive behaviour. • Encourage contestable market structures. • Implement price controls.
Insufficient Countervailing Power	• Encourage more contestable market structures. • Allow mergers in weaker sectors.
Negative Externalities	• Impose a tax to align financial costs with economic costs. • Create tradeable rights. • Enforce minimum standards.
Positive Externalities	• Create limited rights so firms may charge a higher amount for a limited period to recover their costs. • Provide tax concessions. • Introduce public funding or subsidies for the provision of the good or service.
Public or Non-excludable Goods	• Facilitate voluntary levy collection. • Encourage new technologies that facilitate charging. • Provide the good publicly through competitive bidding. • Provide tax concessions or subsidies.
Information Asymmetry	• Undertake a public information campaign. • Introduce minimum standards. • Require accreditation. • Introduce occupational licensing. • Introduce disclosure requirements. • Introduce strict penalties for false advertising.
High Transaction Costs	• Encourage use of standard and simplified contracts. • Remove barriers to economies of scale in contracting.