How has the scope and range of economic regulation changed for the private sector in recent years and what is the outlook for the future?

The Australian Competition & Consumer Commission’s Perspective

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Introduction

The message of this paper is captured in the following extract from John Rawls’ *A Theory of Justice*,

*Perfect competition is a perfect procedure with respect to efficiency.* (Page 272)

Competition Policy Generally

The purpose of competition law is to ensure that free markets work. Overall this requires competition among firms and accurate information in the hands of consumers. Competition between firms selling to informed consumers will lead to the best prices and the best quality (or perhaps the best value, being a combination of quality for price). Competition spurs efficiency and innovation. It gives firms the motivation to strive to lower costs, lower prices, increase quality and provide better back-up services. It drives firms to produce what consumers want.

Competition is about ensuring that no firm can ever take its customers for granted. It is about ensuring that producers are always looking for better ways of doing whatever it is they do.

However, effective competition always makes people feel uncomfortable. Firms can never sit back and admire their achievements in a competitive market because they always fear being overrun by the opposition if they stop striving to do things better. This provides a powerful incentive for people to seek ways of stopping the competitive process. Competition laws are required to counter that incentive by providing a strong disincentive to anti-competitive conduct.

Economic Regulation

Economic regulation is aimed at improving economic efficiency by introducing competitive forces into essential facilities of national significance which display monopoly characteristics.

Any inefficiencies in infrastructure provision directly impact on economic growth, competitiveness, productivity and ultimately on living standards. Bringing the cost and efficiency of infrastructure services at least into line with world best practice is therefore a central focus of micro-economic reform.

However, where natural monopolies exist it will not always be possible or efficient to introduce competition and therefore achieve enhanced consumer welfare. In these circumstances, government intervention, in the form of new and improved regulatory institutions, instruments and policies, as well as pro-competitive reforms, is justified.

In this paper I will address the following issues:

- An overview of Competition Policy in Australia and internationally;
- The regulatory role of the Australian Competition and Consumer Commission (“ACCC”);
• A discussion of the role of competition in corporate governance;
• The importance of economic regulation, and the considerations to be addressed in maintaining an effective regulatory regime; and
• A discussion of how effective corporate governance can assist in addressing the current problems with economic regulation in Australia.

National Competition Policy in Australia

Traditionally competition policy has been perceived fairly narrowly, with legal prohibitions on anti-competitive agreements, misuse of market power, and anti-competitive mergers. However, views have altered, and competition policy is now perceived to have a wider role.

Reasons For Competition Policy

In most countries unrestricted competition is not a goal in itself. Competition generally promotes efficient allocation of resources and ultimately economic growth which benefits all participants in the economic process. However, the aim of competition policy is not exclusively related to efficiency. Competition should be thought of as a dynamic process of rivalry for sales between market participants and potential market participants, who invest capital in the production and development of goods and services. In addition, competition policy may encompass a broader set of policy objectives including consumer welfare, more equitable income distribution and encouragement of small business. However, there is a presumption in favour of competition unless it can be shown that efficiency or some other public policy goal overrides it.

Why Is Competition Preferred?

Central to competition policy is the assumption that there is something undesirable about an environment in which there is less competition compared with one in which there is more competition. Under normal circumstances, a competitive market structure will allocate resources in such a way as to produce the goods and services which consumers value most highly and are prepared to pay for, and it does so at the lowest possible cost in terms of resource use.

On the one hand, competition is held to be efficient. In a highly competitive market, the individual firm is so small in terms of total market supply that it will have no impact on market price, irrespective of whether it chooses to produce a very large output or a very small output. Assuming that the firm sets out to maximise its profits, it will choose to produce the output which results in the lowest average cost of production. In this way, production efficiency is achieved. Similarly, as there are no barriers to entry/exit to a competitive market, resources will move into/out of the market in response to price changes which reflect the value consumers place on these products, thereby achieving allocative efficiency.

On the other hand, if there is only one seller in a market, that monopolist will restrict output below the competitive level in order to raise prices. This means that, for corresponding technology, higher average costs will be incurred and so the industry is
technically inefficient. The monopolist will not achieve allocative efficiency as too few resources will be allocated to production.

Thus, competition policy is based on the belief that a competitive market will result in economic efficiency and increased social welfare. Ideally competition policy should be non-interventionist and non-regulatory. It would leave market forces to operate. In practice, however, this is not possible.

**Competition Policy Reforms**

In 1991 the Commonwealth, State and Territory Governments agreed to examine a national approach to competition policy. This occurred within the Council of Australian Government’s (COAG) framework, and was unique in its high level of co-operation. However, it is my view that the desired level of regulatory co-operation to emerge from this marriage between the Commonwealth and the States/Territories has subsequently resulted in a regulatory divorce. National Competition Policy is now characterised by multiple regulation and inconsistent regulatory policies. I intend to address how this dilemma can be resolved later in this paper. At this stage, I would like to provide a brief overview of the actual Competition Policy reforms.

A National Competition Policy Review Committee chaired by Professor Fred Hilmer was established. On the completion of this committee’s report in 1993 (the Hilmer Report) and after extensive public consultation on the report’s recommendations, the various governments, as part of COAG, agreed to implement the recommendations by way of the *Competition Policy Reform Act 1995*. The reform package included amendments to the *Trade Practices Act 1974* and the *Prices Surveillance Act 1983*, the formation of the National Competition Council and the merger of the Trade Practices Commission and the Prices Surveillance Authority to form the Australian Competition and Consumer Commission.

The reform legislation was complemented by two inter-governmental agreements:

- **The Conduct Code Agreement** -- This sets out processes for amendments to the competition laws of the Commonwealth, States and Territories and for appointments to the Commission. It provides for participating governments to:

  1. pass appropriate legislation to apply the *Competition Policy Reform Act 1995*; and

  2. to notify the Commission of any exceptions to the application of the *Trade Practices Act 1974* via section 51(1).

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1 Prior to the legislation, section 51(1) provided that a State or Territory (as well as the Commonwealth) could override the Act by passing legislation that specifically authorised behaviour that would otherwise be in breach of the Act. Whilst this will remain possible under the new legislation it will be more difficult, more visible and perhaps more embarrassing for States and Territories, and the Commonwealth itself, to do this. A number of transitional provisions accompanied the phasing in of this new approach to jurisdiction under the Act.
• **The Competition Principles Agreement** -- This sets out arrangements for appointments to, and deciding the work program of, the National Competition Council. It also sets out the principles that governments will follow in relation to prices oversight of government business enterprises, structural reform of public monopolies, review of anti-competitive legislation and regulations, access to services provided by significant infrastructure facilities and the elimination of any competitive advantage or disadvantage experienced by government businesses when they compete with the private sector.

Within the COAG framework, the Commonwealth, State and Territory Governments are currently undertaking a review of the operation and terms of the inter-governmental agreements that underpin National Competition Policy.

**Micro-economic reform**

The critical role of the utility sectors was recognised by all nine Australian governments in 1995 when they committed to the National Competition Policy reform package. In summary, notable features of the reform package included:

- incentive-based regulation of revenues or prices of natural monopolies;
- third-party access to infrastructure services to create opportunities for upstream and downstream competition;
- corporatisation or privatisation of government utilities so that resource utilisation and service provision mimics outcomes in a competitive market;
- winding up of territorial franchises; and
- jurisdictional review of legislation that restricts competition, subjecting it to a net public benefits test.

Each government agreed to abide by various principles in the reform of public monopolies including:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation 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; and
• the efficient allocation of resources.

Structural reform

The traditional view of public utilities in Australia was that they were natural monopolies and as such it was in the interests of the community that they should be owned and operated by government.

A re-examination of this approach suggested that, generally, only part of a particular public utility in fact possessed natural monopoly characteristics; this was usually the distribution function (such as an electricity grid, a gas pipeline system or a system of railway tracks). This, together with other considerations such as concerns about public sector productivity and the need to curb the growth in government expenditure, resulted in Australian governments undertaking extensive structural reforms to introduce competition into the areas of the markets served by utilities.

Further, before introducing competition into a sector traditionally supplied by a public monopoly, governments in Australia agreed to remove from the public monopoly any responsibility for industry regulation, and to re-locate this function so as to prevent the former monopolist enjoying a regulatory advantage over its rivals.

A further consideration was to ensure the public monopolies weren’t simply converted to private monopolies. Apart from reproducing all of the problems associated with a public monopoly, a private monopolist would have greater incentives to maximise profits with less concern for public policy considerations such as health, safety and quality of service.

Mechanism for Regulation of Natural Monopolies

During the reform process, it was recognised that in situations where competition cannot be injected through disaggregation and a monopoly situation is therefore likely to continue, an appropriate solution is to provide for economic regulation through:

• the implementation of mechanisms to prevent monopoly pricing in markets that are, due to their structure, not competitive (such as access arrangements, undertakings or prices oversight); and

• providing strong incentives to participants in those markets to improve the efficiency of their production, resource allocation and investment decisions and to minimise costs to ensure the effectiveness of the mechanism in providing benefits to consumers.

These reforms introduced a comprehensive competition policy into Australia which has assisted the process of building a strong culture of good corporate governance.

Globalisation and International Competition Policy

These competition policy reforms have occurred against a background of globalisation. The international factor in the economic activities of countries has been increasing greatly in recent decades. Trade has grown even faster than economic growth in the last
50 years - so also have foreign investment and international capital flows. The causes of this include:

- Economic growth itself which both creates ever increasing demand for imports and also increases the capacity of economies to produce exports. It also generates greater amounts of savings which may be invested domestically and internationally to meet the greater investment demands associated with economic growth.

- Technological innovation. This pervades most fields of economic activity but is especially great in the areas of information and communication technology. A sector particularly affected by technological growth in these areas is the financial services sector, which, in turn, facilitates higher degrees of financial and economic interaction between economies in different countries.

- Falling transport costs.

- International, as well as domestic, liberalisation of trade, investment and economic activity generally.

Generally speaking, globalisation has positive effects on promoting competition and in widening consumer choice. However, it can be associated, in some cases, with anti competitive behaviour on an international scale and this can pose problems for national governments which have difficulties in dealing with behaviour taking place in other countries that can affect their own economies.

I would like to discuss one sub set of the problems concerning the international dimension of competition policy. This concerns the interaction between trade and competition policies. I emphasise that this is only one aspect of the global competition scenario but this fact is not always recognised. The essence of the debate about the interaction between trade and competition policy can be summarised as follows below.

First, trade policy liberalisation can be frustrated by failures in the enforcement of competition policy. For example, supposing a country liberalises trade, allowing a potential flow of imports following the reduction or elimination of trade barriers. The benefits to consumers of this liberalisation can be defeated by restrictive practices in the liberalising market. For example, retailers in the liberalising market may reach agreement with manufacturers in the home market not to accept imports. Entry into that distribution sector may be difficult. Trade policy liberalisation in such cases can clearly be frustrated by failures to enforce competition policy properly, eg, if the regulator does not exist or fails to take action to stop anti competitive practices.

Second, it is important to note the reverse relationship. Trade policy can be highly anti competitive. For example, nearly all forms of import protection whether they be quotas, tariffs, anti dumping laws and so on can reduce competition and damage consumer interests. It is important that the debate about the damaging effect on trade of failures in competition law enforcement be balanced by recognition of the damaging effects on competition and consumers of trade restrictions.

Third, it is important to note that there is another extremely important variable which may be at work – regulation. Very often it is Government regulation rather than failures in the enforcement of competition law that are the true obstacle to imports, and
trade liberalisation and competition working. What is needed is a three-way debate about the relationship between trade, competition policy and regulation, rather than a debate that is focussed too narrowly on trade protection and failures in competition law and enforcement.

Intellectual property laws are an interesting example. Intellectual property law has been captured by the interests of producers in countries which are net exporters of intellectual property. In particular, the statutory restrictions on parallel imports under copyright law have enabled massive unjustified price discrimination between countries, have hindered and distorted competition and imposed draconian restrictions on international trade. I am heartened that some change is occurring in some parts of the world – New Zealand has abolished parallel import restrictions, Australia has removed restrictions in some areas and Japan’s Supreme Court has relaxed them in patents.

Globalisation raises a number of policy implications for decision-makers. There seems to be six options for addressing global competition issues:

- Extraterritorial application of laws.
- Enhanced voluntary convergence in competition laws and enforcement practices.
- Enhanced bilateral voluntary cooperation between competition agencies.
- Regional agreements containing competition provisions.
- Plurilateral agreements.
- Multilateral competition policy agreements.

Of these, I will discuss the bilateral and multilateral approaches.

**Bilateral Approaches**

There are number of forms of Bilateral Cooperation Agreements. They are:

- Non-binding, voluntary exchange of non-confidential information and of technical expertise.
- Traditional Comity.
- Positive Comity.
- Bilateral agreements of treaties permitting exchange of confidential information on a case by case basis eg the Australia/US Treaty.
- Mutual Legal Assistance Treaties.

**Multilateral Competition Rules**

The key elements of a framework are:
Core principles (fundamental principles of general application - probably binding). Core principles include:

- National treatment, Non-discrimination;
- Transparency;
- Due process (Rights to Remedy under Competition Laws);
- Scope and coverage of competition laws; and
- International cooperation.

Common standards (more detailed and specific commitments by countries - probably binding) and approaches (list criteria or objectives without detailed weighting - may be binding or non-binding). These include:

- Hard core cartels;
- Vertical restraints; and
- Abuse of dominance (mergers).

Advisory forum on institutions and enforcement;

Principles of enforcement (including rights of remedy);

Bilateral cooperation forum;

Dispute settlement arrangements; and

Sectoral approaches.

The relationship between the Multilateral and Bilateral options raises the issue of whether there is complementarity or conflict between multilateral and bilateral approaches. Whether we go down a bilateral or multilateral, or a mixed bilateral and multilateral path is the issue which is being faced in international discussions at present. It is difficult to forecast the outcome. The most likely is perhaps that the World Trade Organisation will give further study to the options, leaving open the possibility of some negotiations on these topics in coming years.

The promotion of consistent regulatory principles and practices domestically, regionally and internationally may require:

- Independent oversight by the World Bank and other global agencies involved in economic reform issues to ensure that structural and regulatory reforms and transitional measures are implemented prior to and continued after privatisation;
- A refocussing from predisposition to privatisation to policy formulation and advice focussing on all the available options to meet the economic and
social needs arising from modernisation of government enterprises and utilities;

- Provision of independent research expertise, through the International Energy Agency or other bodies, to evaluate whether target benefits in production efficiency, resource allocation and pricing are being delivered;

- Aid from experienced partner countries in capacity building regulatory institutions, including regulatory agencies, legal and consumer advocacy bodies and community education initiatives; and

- Sponsorship of cross-border regional regulatory forums.

These issues need to be addressed because the forces giving rise to globalisation are likely to generate more widespread and serious adoption of competition policies at national levels.

**The Regulatory Role of the Australian Competition & Consumer Commission**

Section 2 of the *Trade Practices Act* articulates the broad objective of the ACCC thus,

> The objective of the *Trade Practices Act* is to enhance the welfare of Australians through the promotion of competition and fair trading and providing for consumer protection.

In Australia, the ACCC has significant responsibilities in the telecommunications, energy and transport industries associated with the competition policy reforms described above.

The framework for regulation has been developed broadly for third party access as well as price and revenue cap regulation of infrastructure services in these sectors.

In telecommunications the ACCC’s role in economic regulation is twofold involving both regulatory pricing and access work:

- Its access work involves facilitating access to the networks of carriers. This includes declaring services for access, approving access codes, approving access undertakings, arbitrating disputes for declared services and registering access agreements.

- Other aspects of the ACCC’s role in telecommunications include price control of Telstra’s retail service, international conduct rules, number portability, electronic addressing, interconnection standards and arbitration of disputes about: access to network information, access to facilities, operator services, directory assistance services, provision of number portability, preselection, emergency call services and carriage services for use by the Defence forces.

In the electricity sector the ACCC’s functions include:

- assessing applications from participants in the electricity industry for acceptance of changes to the National Electricity Market Access Code;
• assessing access undertakings submitted to the ACCC by individual network service providers and approving changes to those undertakings as submitted from time to time; and

• regulating the revenues of transmission network service providers, including formulating a Draft Statement of Principles for the Regulation of Transmission Revenues released in May 1999.

In the gas sector the ACCC’s functions include:

• contributing to the process of developing a national framework for access to transmission and distribution infrastructure in the gas industry;

• consideration and approval of access arrangements submitted by service providers under the National Third Party Access Code for Natural Gas Pipeline Systems. This process is focused on setting reference tariffs, which requires determination of a range of measures including asset valuation, a fair allocation of justified costs, a reasonable rate of return and an acceptable depreciation methodology; and

• arbitrating disputes relating to the terms and conditions of access.

In the transport sector, the ACCC’s work primarily covers airports, rail and the waterfront sectors but at this stage, primarily concerns the economic regulation of leased airports. The regime comprises a package of measures under the Airports Act 1996, the Trade Practices Act 1974 and the Prices Surveillance Act 1983 and the main measures are a price cap on aeronautical services and access arrangements. The package also includes a number of complementary measures including formal monitoring, quality of service monitoring and a review of regulatory arrangements.

Further, it must be emphasised that, in order to be effective, regulation needs to be incentive-based.

Incentive Regulation

Incentive regulation aims to replicate the assumed beneficial effects of competitive markets – that is, achieving optimal efficiency in production, pricing and economic welfare – by encouraging competition, innovation, economic investment and fair dealing by suppliers with users.

On a more practical level, incentive regulation is the use of rewards and penalties to induce the utility to achieve desired goals where the utility is afforded some discretion in achieving goals. It involves setting parameters for revenue recovery that encourage efficiency and incorporating explicit mechanisms for sharing the benefits of efficiencies between utility owners and users.

The theoretical underpinning for incentive regulation is that with the ability to retain cost reductions as profits, the service provider has a strong incentive to be more efficient in the provision of access services and to expand its market share and to contribute to market growth.
If regulation adjusts prices to simply allow the service provider to recover costs and achieve a normal rate of return on investment, the service provider will have little incentive to be efficient in the provision of such services; indeed there may be an incentive to reduce efficiency. Hence the need for incentive-based regulatory mechanisms.

There is a large and expanding body of literature on incentive regulation but it is clear that an effective regulatory framework has the following features:

- public decision-making processes, with accessible, timely information at the level required to meet regulatory objectives;
- clear definition and commitment, with review of revenue or price caps and service standards at defined intervals or on the occurrence of defined ‘triggers’;
- a revenue/price cap based on forecasts of the cost of service including return on capital (asset base) over the regulatory review period;
- risk-adjusted rate of return on the asset base commensurate with prevailing conditions in the market for funds; allowable return determined on a post-tax nominal basis, with estimated tax for the regulatory period explicitly part of the cost of service;
- annual ‘CPI-X’ adjustment of the cap and inflation adjustment of the asset base, with efficiency gains and revenue-smoothing reflected in the ‘X’;
- periodic revaluation of assets where justified according to a consistent theoretical basis;
- depreciation recovery over the economic life of the asset, providing an efficient time profile of revenues and tariffs;
- sharing of efficiency gains by a formula such as a ‘glide path’;
- explicit published service standards and implementation support mechanisms such as consumer charters; and
- independent dispute resolution accessible by users.

**Competition and Corporate Governance**

An effective competition policy is a fundamental pillar necessary for ensuring a culture of good corporate governance.

In the context of promoting good corporate governance competition between firms will operate to:

- Promote well informed investment decisions;
- Ensure accountability for business decisions;
• Ensure transparency in business transactions; and
• Assist in achieving the goal of effective resource allocation.

As competition by its very nature improves economic efficiency, firms that display efficient business practices, including governance will succeed when judged by the basic principles of economics. Public and private firms as part of a good approach to corporate governance, need to be aware of the competitive environment in which they operate. This includes an awareness of the scope of competition within their relevant markets, likely anti-competitive practices they will encounter, and the need to ensure adequate fair trading and consumer protection measures are implemented.

Economic regulation is aimed at ensuring economic efficiencies are realised through competition. In the case of traditional infrastructure monopolies incumbent firms have faced the entire spectrum of anti-competitive practices. For example, barriers to entry created by public policy, access issues and traditional market power of the monopoly. In addition, incumbent firms have been faced with price-fixing arrangements, and monopoly profits have been construed as the achievement of economic efficiency. This business environment is not conducive to good corporate governance, hence the need for an independent and effective competition regulator. Competition policy is directly aimed at preventing anti-competitive practices and business initiatives or policy reforms that facilitate these practices. However, as discussed competition policy encompasses far broader objectives than pure economics.

Competition policy is aimed at ensuring efficiencies in all aspects of society. It strives to ensure the welfare objectives of a community are realised. This is illustrated in a co-operation agreement entered into between the Australian Competition & Consumer Commission and the Australian Greenhouse Office (AGO) signed on 17th March 2000. This agreement provides a guide on how the ACCC and AGO will work together to protect the interests of consumers and ensure that Australia meets its commitment to reduce greenhouse emissions. This agreement demonstrates the practical operation of good public sector governance playing a central role in achieving the objectives of competition policy.

**Example: The Australian Telecommunications Experience**

The Australian telecommunications experience provides an example of the problems impacting on good corporate governance, which have been sought to be rectified by the competition policy reform package discussed above.

Telstra has considerable market power arising from its control of twisted copper pair wires that connect households and businesses, and Telstra’s Public Switched Telephone Network, which are required for telephone access to most consumers. This facility is known as the Customer Access Network, or the local loop.

The local loop is used to provide telephone services. It provides the first and last step in the network for the supply of local, national and international calls, as well as some other services. To compete in these services, competitors must have access to the local loop or have duplicate facilities of their own. New entrants therefore face a decision
whether to build new telecommunications network infrastructure, or buy network services from Telstra.

The access regime established by the National Competition Policy reforms, allows for competitors to have access to the local loop in circumstances where it would be uneconomical or not feasible to duplicate the local loop or have other competing infrastructure. Without such a regime, Telstra could potentially favour its own downstream services or withhold entirely the use of the facilities to competitors. Competition would therefore be stifled.

Part XIC of the Trade Practices Act requires the ACCC to seek to promote the long-term interests of telecommunications end-users.

Briefly, the telecommunications regulatory (access) regime provides that:

- the Commission may declare a service – that is, decide whether a particular service should be regulated;

- Telstra and other relevant telecommunications firms are subject to standard access obligations when supplying declared services;

- Telstra and other relevant telecommunications firms can submit an access undertaking to the Commission, which the Commission can accept or reject; and

- telecommunications firms can seek Commission arbitration of disputes over access terms and conditions to regulated services.

In assessing access undertakings and arbitrating access disputes, the Commission will attempt to promote the statutory objective of the long-term interests of end-users. It does so by determining terms and conditions that:

- will lead to efficient decisions by new entrants on whether to seek access from Telstra or build duplicate infrastructure;

- will encourage efficient levels of entry into downstream markets; and

- will ensure the infrastructure owner receives suitable compensation for access to the infrastructure service.

It is an important task, given the lasting benefits that can flow to consumers in terms of lower prices, improved quality of service and new innovative services.

In 1998, telecommunications industry revenue was estimated to be approximately $26 billion, around 4.7% of GDP in that year. Therefore, the efficiency and consumer benefits flowing from increased competition and (efficient) new infrastructure investment is significant.
Safeguards against anti-competitive conduct

When introducing the 1997 reforms, it was clear that Telstra still had considerable market power. This was despite the limited competition that had been earlier introduced in 1991, with the market entry of Optus and Vodafone.

One of the key reasons for this continued market power was, of course, Telstra’s continued control of the local loop. It was recognised that the access regime mechanisms would take some time to diminish the market power arising from control of the local loop, and for significant market entry to occur.

There are three additional reasons for Telstra’s market power:

Telstra’s presence in the telecommunications industry

Firstly, Telstra has a significant presence in most telecommunications markets, both at the wholesale and retail level:

- As I mentioned, it has almost exclusive control of the local loop, which is necessary for access to customers.
- Telstra supplies approximately 95% of local call services.
- It has approximately 59% of the long-distance and international voice market.
- It is a major Internet Service Provider.
- It serves around 50% of mobile subscribers.

Telstra’s presence in these markets provides it with the potential to cross-subsidise its competitive services from non-competitive services, although cross-subsidisation is somewhat limited by the Government’s retail price cap controls of Telstra’s tariffs and increasingly by the Commission’s access regulation.

Customer knowledge

Secondly, Telstra is long-standing and a previous monopolist – this provides it with customer knowledge and customers with a strong brand recognition of Telstra. Some customers may stay with Telstra because it is the company they know the best, even when competitors offer lower prices. It may take some time before competitors can overcome Telstra’s head start in terms of brand recognition.

Technology and industry complexity

Thirdly, telecommunications is a highly complex industry, in which technology is developing continually. Determining whether Telstra’s actions are efficiency enhancing or anti-competitive is not always clear-cut and therefore Telstra may have scope to cloud anti-competitive actions behind alleged technical requirements.
For example, Telstra could argue that certain terms and conditions are required for technical reasons. The challenge for the Commission is to determine whether this is the case and that the provisions are not intended to maintain or increase market power.

**Market power in the future**

There has however, been some decrease in Telstra’ market power.

Already we have seen Telstra’s market share decrease. On the long-distance and international markets, estimates put Telstra’s market share at 74% in 1994, at 64% in 1996 and 55% in 1998. At the same time, Optus’ market has only increased from 22% to 25%. The market share of other entrants has been particularly important, increasing from 4 to 20%.

We have also seen significant decreases in consumer prices in many of the major markets. Telstra’s STD call rates have fallen by approximately 25% on average over the last 5 years, while its international calls have fallen by approximately 30% on average over the same time. New entrants are commonly offering even lower prices for many services.

It should be noted that, as new entrants enter the industry, competition will increase and competitive conditions become less fragile, as witnessed by a decrease in Telstra’s market share and by decreased consumer prices.

With this increased competition, the need for supplementary competition provisions diminishes. While there will eventually be reliance only on the general anti-competitive conduct provisions of the *Trade Practices Act*, it is not yet clear when this should occur.

**The message**

In a competitive market, firms will rarely be in a position to generate excess profits. If the market allows for excess profits it is likely to attract new competitors which will affect this profitability. Therefore, a means of “fighting” this competition is for firms to closely assess their operational efficiencies. At the very least, firms must keep their production and administrative costs in line with industry best practice to remain competitive. The practice of “good corporate governance” is a means by which firms can achieve these cost savings.

Business acumen dictates that prudent investors will invest in firms that demonstrate:

- Efficiencies;
- Practical regulatory compliance;
- Treating shareholders equitably; and
- Transparency and accountability.
The practice of good corporate governance will lead to a good reputation, access to finance and the place the firm in a stronger position to compete. In other words, *competition is an incentive for good corporate governance.*

**Maintaining an effective economic regulatory regime**

The question arises why is economic regulation important?

**Economic efficiency**

As previously mentioned, economic regulation is aimed at improving economic efficiency by introducing competitive forces into essential facilities of national significance which display monopoly characteristics. There are often potential efficiency gains from monopoly (or near monopoly) supply of many essential infrastructure services due to economies of scale and scope. While competitive supply of such services by two or more facilities would be inefficient, the monopoly supply of essential facility services also confers a high degree of market power which can be exploited in the form of monopoly pricing or operating inefficiencies.

Monopoly pricing itself creates inefficiencies and distorts resource allocation by raising costs and distorting demand and investment patterns in downstream markets. Therefore, economic regulation has an important role to play in promoting the efficient development and operation of vital infrastructure industries.

**Competitive pricing**

Where there is sufficient competition within an industry, prices will be constrained and quality maximised by competitive pressures. In such an environment it is unnecessary to impose regulation. However, where competition is not feasible there is a case for regulating infrastructure at the bottleneck points in the supply chain.

Therefore, regulation or other incentives are necessary when natural monopoly power exists to guard against monopoly pricing, artificial constraints on capacity and anti-competitive behaviour.

In this way, economic regulation benefits consumers, including business consumers, by operating essential facilities in an efficient and commercial manner while at the same time protecting users from any potential abuse of market power. This has the end result of maximising consumer welfare.

**Maintaining an effective economic regulatory regime**

In designing regulatory principles and processes it is important to promote consistent principles and practices across jurisdictions, both within countries and between countries in the same economic zone. The Australian experience demonstrates certain measures at different levels are necessary to achieve privatisation or other reform measures:
Legislative level

- National competition and consumer protection law with complementary law and codes providing a framework for efficient incentive regulation of essential service providers enjoying natural monopoly or significant incumbency advantages.
- An independent regulatory agency.
- Appeal bodies and bodies for the protection of integrity in decision-making.
- Transparent processes where the regulator is asked to take account of government views.
- Full public participation in regulatory review processes and in developing community service obligations
- Government commitment to ensuring that community service obligations are funded.
- An open approach to considering the full range of reform options.
- Planning and measures to deal with unemployment and environmental issues, and to address contractual and cultural factors that would otherwise favour incumbents.

Regulatory level

- Resourcing a national regulatory body capable of taking an integrated approach to competition, consumer protection and incentive regulation.
- Capacity-building in that body (eg, recruitment, information services and training) to prepare for regulatory reforms.
- Participation in wider regional and international regulatory forums in order to expose regulators to the experience of counterparts and to assist in developing cooperation in regional issues and to develop links with representative business and consumer organisations.
- Compliance education for the business community and community education and outreach programs to consumers, agricultural bodies and small business in urban and regional areas.
- A focus on establishing and maintaining in regulated industries, standards for the quality and level of service and the developing codes and charters to underwrite them, access by consumers to avenues for redress and dispute resolution, and effective information communication to consumers.
- Coordination with other government agencies, advocacy bodies, parliamentarians and relevant enterprises to ensure that communication difficulties arising from illiteracy are surmounted.
Business and rural level

- Introduction of internal compliance education programs in government enterprises and in utilities in the private and public sectors.
- Cooperation by representative bodies in outreach programs and participation in debate to resolve reform implementation issues.
- Cooperation by professional bodies representing lawyers, accountants and other professionals in educating members and reviewing ethical issues arising from the new regulatory framework.

Consumer level

Formation of vigorous, broadly representative and funded public forums and associations to debate and resolve reform implementation issues, such as structural reform, consumer representation and contact points, and input to regulatory code drafting and implementation.

Quality and service issues

In considering economic reform and restructuring, it is important that mechanisms for maintaining quality and service standards are incorporated in the industry structure. Public utilities provide essential services and customers will not have the option of withdrawing their custom in cases of poor quality product or service. In uncontestable markets neither will they have the option of seeking out an alternate supplier.

An emphasis on price regulation alone fails to recognise the interaction between price and quality and service. If quality and service are not safeguarded, the profit motive may encourage retail businesses to reduce the service and/or product quality part of the price/quality mix, without falling foul of any pricing regulation.

Quality and service issues that are relevant in utility industries include technical and product quality aspects, and less technical, primarily service quality aspects.

Technical and product quality aspects include:

- continuity of supply;
- product quality (for example, electricity voltage, water purity, and clarity of telephone connections);
- emergency / safety procedures;
- security of supply;
- health and safety aspects;
- environmental sustainability; and
- privacy aspects, for example, the ability to intercept telephone conversations.
Service quality aspects include:

- debt and disconnection procedures;
- timing of, and keeping of, appointments;
- billing / metering procedures;
- new supply procedures;
- quality, speed of repairs and maintenance of equipment;
- supply disruption procedures;
- ease of transactions;
- comprehensibility of documents;
- staff responsiveness;
- working order of equipment;
- communications with customers; and
- provision of advice / usage services.

Where they have existed, quality and service standards in Australian public utilities operating in non-competitive markets have been set using a combination of legislation and customer service guarantees. For many quality and service issues, however, specific standards have not been prescribed but have been monitored through mechanisms of public accountability. However in some situations it may be more appropriate for explicit quality and service standards to be set.

**Addressing the problems with Economic Regulation**

As discussed, reform and deregulation of public utilities has been a major feature of micro-economic change in recent years. This changing environment has also involved a reshaping of the role of regulators. The challenge for regulators in coming years is to ensure that their work is consistent with the development of genuine markets.

As previously mentioned, regulators must also address the problem of “regulatory overdose” which has been an attribute of complex competition policies.

There are a number of transitional measures, which have been necessary in the move to reform. These should not become ends in themselves. Otherwise, a short-term focus will actually hinder rather than help the implementation of competition and national markets. Yet there are ongoing issues that suggest this is a real possibility.
In electricity, the presence of local market power held by generators and/or retailers is still an issue for both the development of existing competition and the viability of competitive new entry. Structural reform, particularly the separation of monopoly and contestable elements, is vital for getting the fundamental drivers of competition reform right in the first place. However, it is also critical that horizontal separation is sufficient to sustain competition.

The nature of government involvement in markets is also a major concern. For example, one concerned participant in the gas industry recently used the experience of the initial arrangements that led to the development of the North West Shelf as a warning of what can result from excessive government intervention in a major resource development. To facilitate the North West Shelf development, the Western Australian Government entered into long term take or pay contracts with the producers for volumes significantly in excess of the existing WA market requirements. The market did not expand rapidly in the way required to utilise all the gas contracted for, and the WA Government was making significant losses. Eventually, the Commonwealth Government had to come to WA’s assistance by passing legislation with the effect that it would forego significant royalty revenues on domestic gas sales from the North West Shelf until 2005.

Preventing Regulatory Overdose

In the context of electricity, our federal system has been replicated in the regulation of the electricity market at the national and State level. The Commission has a key role as national regulator of the transmission network. The State regulators have their role in such areas as distribution and retail pricing. This requires a coordinated approach to common issues, which ensures there is no unnecessary inconsistency or overlap.

The States and State regulators, such as IPART and the Office of the Regulator-General will have ongoing roles in the regulation of the distribution and retail networks. The ongoing roles of these bodies include:

- Distribution network pricing;
- Environmental protection;
- Safety regulation; and
- Franchise customer pricing.

Over time the Commission will carry national responsibility for regulating transmission network revenues in electricity. As part of its Regulatory Principles project, the Commission will work to develop a consistent set of principles and applications for electricity on such areas as revenue cap methodology, tax and depreciation approaches and CPI-X incentives.

The Commission has also taken the lead in establishing its Energy Committee (in which State regulators participate) and in the development of the Regulators’ Forum, both are ways of maintaining regulatory consistency. The Commission’s Energy Committee provides regulators with the opportunity to voice their concerns and
opinions on matters before the Commission. The Regulators Forum also provides an appropriate forum for discussing relevant issues. These arrangements have been constructive and useful for all concerned. However, the issue of consistency is one that needs to be monitored to ensure that regulatory costs do not dissipate the benefits of competition reforms.

**Conclusion**

The message of this paper is clear. *The economic principles achieved through competition do provide incentives for public and private sector firms to practice good corporate governance.*

The future of competition policy and reform in Australia is expected to be both challenging and exciting. Recent trends have shown that a culture of healthy and legal competition between firms has developed in Australia since the introduction of the *Trade Practices Act*.

Effective competition is the key to efficiency and productivity in business. It is the factor that encourages innovation, cost and production efficiency and enhanced consumer satisfaction by businesses striving to keep ahead of their competitors. However, stiff competition also creates incentives for ‘unethical firms’ to ignore the principles of good corporate governance to beat their rivals, and this is where the ACCC as an independent, effective and strong competition regulator must intervene.