

Challenges of Economic Regulation in Queensland

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The discipline of economics is at its best when it asks the big questions about production, distribution and exchange – think of seminal figures such as Smith, Ricardo, Keynes and Schumpeter. More recently, some pioneering Nobel laureates, including the 2016 prize winners, Oliver Hart and Bengt Holmström, have shown that economics is at its most useful when it promotes creativity, collaboration and connectivity – which applies to economic regulation, too.

What is a definition of economic regulation? It could be viewed from an angle of ‘market failures’, but an opposite way of looking at it is in terms of opportunity – a way of ‘making markets work better’. Economic regulation could be seen as ‘government-sponsored intervention in market decisions that empowers markets to work better by promoting competitive, market-like outcomes’. Economic regulation may involve access regulation and price regulation.

Alongside the opportunities that economic regulation opens up, economic regulators also face many challenges. Regulators deal with complex and difficult pricing and policy issues in an environment where stakeholders can hold strong, diverse positions and have opposing objectives. In Queensland, where the Queensland Competition Authority (QCA) has the role of the state’s economic regulator, it is no different.

In such an environment, it is the economic regulator’s independence which distinguishes it. Independence can give stakeholders confidence that decisions are made while the influence of vested interests is removed, political interference is absent and all parties’ opinions are heard. As the regulator, the QCA must therefore, at the same time as it creates opportunities for others to have their say, remain independent of others’ objectives and true to its own objective – which is to promote competition (mainly in the areas of access, water prices and retail electricity).

With this independence comes the onus on the regulator to clearly explain the reasons for decisions and to make sure processes are as transparent and predictable as possible. Decisions following from economic regulation have a significant effect on the Queensland economy and community and must therefore be understood well.

The scope of economic regulation covers pricing and terms and conditions, and the regulator does not always have the information available to other stakeholders. In respect of access, the regime in Queensland enables third parties to access significant infrastructure that cannot be economically duplicated; the objective, ultimately, is that they can do so on reasonable terms and conditions. The QCA can arbitrate and determine access disputes, but an approved access undertaking gives providers and access seekers greater certainty than if they rely solely on QCA arbitration. The QCA seeks to limit unnecessary and expensive access disputes.

However, there is always the risk of seeking to impose too much certainty by narrowing matters that could be resolved via negotiation. Also, imposing unnecessary prescription can be prone to regulatory error. Therefore, it is essential to strike a balance. Access undertakings should form the basis for structured and efficient negotiation.

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Other complexities can arise around access regulation, where monopolists and users have become more sophisticated in advocating their particular positions during regulatory processes. Parties may seek to influence commercial outcomes within regulatory processes.

Stakeholders may also have an incentive to seek to delay processes, which can be costly and reduce certainty. The QCA now proactively commences draft access undertaking investigations using mandatory processes. These processes provide regulatory certainty to all stakeholders about the process and timing for approving a draft access undertaking.

An additional challenge for the modern-day economic regulator lies in finding ways to incorporate innovation and technology in its goals. Most competitive markets embrace these elements and the transformations they bring. Also, productivity-enhancing innovation – in terms of how to make incentives work in an organisational setting – is something economic regulators would do well to pursue.

What does economic regulation mean?

A conventional view of economic regulation would see it simply as a way of addressing 'market failures'. An alternative approach is to look at economic regulation as a way of 'making markets work better'. This approach is about promoting competitive, market-like outcomes, which is as much an art as it is a science.

In principle, economic regulation may involve:

- access regulation – where access to a monopoly service is needed by businesses to compete in upstream or downstream markets
- price regulation – where competitive pressures on a supplier of a good or service are not sufficient to achieve efficient prices or to protect the interests of consumers.

Not to be overlooked is the transformational role of innovation and technological change. Most competitive markets embrace innovation and technological advances, and it must be a stretch goal for economic regulation to incorporate these elements too.

In summary, economic regulation can be defined as government-sponsored intervention in market decisions that empowers markets to work better by promoting competitive, market-like outcomes.

In the absence of competition, even the best-intentioned and well-operated monopolies need an independent expert regulator to keep an eye on

things – at the very least in the form of light-handed price monitoring. The aim is to impose the lightest regulatory burden to achieve the most efficient outcomes for the wider economy.

The QCA and its Role in Economic Regulation

The QCA is Queensland's independent economic regulator. It was established in 1997 to promote competition as the basis for efficiency and growth in the Queensland economy. The QCA's primary role is to ensure monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

Broadly, the QCA's role in economic regulation covers three areas:

- access regulation – in particular, Aurizon Network's central Queensland coal rail network, the Dalrymple Bay coal terminal in Mackay and Queensland Rail's track network. But the QCA Act also provides a generic third party access framework that could apply to other infrastructure in the state, such as water facilities.
- water pricing – in line with referrals for price monitoring or pricing recommendations and monopoly water supply activities. A lack of competition in the supply of water services can potentially result in unnecessarily high prices or substandard service quality.
- retail electricity pricing – mainly focused outside the south east Queensland region, where retailers cannot compete with Ergon Energy's subsidised prices and competition is therefore limited. Now that the south east Queensland electricity market has been opened up to full retail competition, the QCA has also been given a monitoring role in that market.

The QCA's counterparts in the other states and territories – that is, other utility and pricing regulators – all have unique roles in economic regulation. They predominantly regulate government-owned businesses while also undertaking some other activities.

At the national level, there is the ACCC, which features in the media very frequently, usually on the matters of mergers and acquisitions or consumer protection. All Australian regulators share experiences and work together to achieve better outcomes, including through the Utility Regulators Forum.

The Government and the QCA

In the context of economic regulation, it is critical to understand the respective roles of the government and an economic regulator. One could draw an analogy with architectural design and construction.

When the University of Technology Sydney decided to create a new building for its Business School, it looked for an architect who could reflect and reinforce the Business School's innovative approach to business education. It found those skills in the world-renowned architect Frank Gehry, who was signed up for the project.

The completed building has a brick façade with striking curved lines. As it turned out, the construction itself was a technical feat, with each of the 320,000 custom-made hand-laid bricks being tied individually to the main steel infrastructure (UTS 2016).

Something that became clear during the construction is that Gehry designs 'from the inside out'. What happens inside the building – the teaching, learning and 'social' spaces – matters most. The design encourages communication and collaboration. It provides the space for developing 'boundary-crossing' skills as well as for gaining specialised discipline knowledge.

How does this relate to the economic regulation task?

First, the Queensland Government sets the policy objectives and legislative requirements. In this sense, it is the architect – it sets the overarching framework, and determines the vision and generally the key elements of design that are essential. The QCA, by comparison, is more like the master builder. It is given the task of translating these design elements and architectural models into reality; therefore, it is concerned with the detail of the project. The QCA, similar to other economic regulators, has been created by a statute. Legislation outlines the tasks of the QCA as economic regulator, and the QCA Board administers the statutory obligations.

While an architect has a vision about how the finished product will look, the builder chooses the materials and methods that best deliver this vision. Ultimately, a building must be functional – the challenge is to construct spaces for end users that are conducive to optimal outcomes. As the builder, the QCA is neither the end user nor the tenant of the building.

Economic regulation is defined above as government-sponsored intervention in market decisions that empowers markets to work better by promoting competitive, market-like outcomes. The role of the regulator in the context of this definition is

to pursue economic efficiency, albeit in the context of government-sponsored action.

Independence of the regulator

A clear separation between government policy settings and the roles performed by economic regulators such as the QCA is central to the regulators' value. An economic regulator is well-placed to avoid regulatory decisions being inappropriately influenced by vested interests and to resist 'regulatory capture'. The regulator's independence from the government means that stakeholders can have confidence that there is no political interference and that transparency is key.

The QCA provides the Queensland Government with an established body of economic and legal expertise to address complex pricing and policy issues in a well-understood, transparent and predictable way. Both sides of politics have supported the QCA in its functions.

By taking the 'politics' out of decision-making and by promoting good processes that give all parties an opportunity to have their say, the onus is on the QCA to clearly articulate its reasons for decisions. This is essential, as regulatory decisions have a significant effect on the Queensland economy and community.

Prior to the QCA making a decision, there is always a rigorous consultation and assessment process, which actively involves interested stakeholders. As a result, the QCA is well-placed to find pragmatic solutions to what are generally difficult and inherently complex problems. A regulator often has to reconcile widely divergent positions; yet, its role is not to win friends by favour, but to make decisions that explain the issues and its reasoning. Regulatory respect is what the regulator would hope to gain. An area of divergence, for example, is regional electricity prices – electricity consumers want the cheapest price, but the electricity retailer wants the most profit, while the government seeks to balance affordability and an appropriate return to taxpayers.

Access Regulation – How it Developed

The QCA was established in 1997 by the Borbidge Government against the backdrop of the broader suite of microeconomic reforms that were agreed by Australian governments around that time. The process of reform began earlier, in October 1992, with the then prime minister Paul Keating establishing the National Competition Policy Review, usually referred to as the Hilmer inquiry.

Broadly, the competition policy framework would 'facilitate competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or

conflicts with other social objectives' (National Competition Policy, p. xvi).

Access regulation seeks to address the lack of effective competition in markets for infrastructure services where access is required for third parties to compete effectively in related markets. The primary objective is to facilitate a commercial negotiation between an access seeker and the infrastructure provider, with recourse to arbitration if the parties cannot agree on the terms.

It is important to remember that the nineties was a very different time, not just because of the economic downturn, but also from a structural perspective. State governments owned and operated an expansive range of monopolies that provided services needing some form of 'competition catalyst'.

The QCA was never intended to be the panacea for every monopoly, nor an advocate or opponent of privatisation, but rather, the means to build regulatory frameworks that would meet the competition objectives of the government. At that time, to support third party access, there was an aspiration to reduce levels of spare capacity by opening up infrastructure facilities to competitive forces.

The apparent 'productivity miracle' in key utilities during the initial phase of microeconomic reform was mainly due to short-term profit maximisation through cost-cutting or by avoiding expansionary investment. The focus was on cost efficiency rather than dynamic longer-term efficiency gains. Cost reduction, just to keep prices down, can in such cases lead to prices being too low. But at some point, what happens when conditions change and infrastructure is 'urgently' needed?

In the case of Queensland's coal rail and port infrastructure, it was boom times after 2005. The word 'boom' was even replaced in public discourse with the concept of 'step change in demand' – because a boom-bust cycle was never expected.

Evidence shows, however, that where investment is materially delayed, it can result in investment occurring at the height of demand. The costs of catch-up investment are obviously the opportunity cost of the delay, but also peak construction costs in times of market exuberance. The costs that arise in this way could be seen as forming a cost-input inefficiency known ironically as 'gold plating', something loathed by neoclassical economic thinking.

Therefore, there is a practical and long-term perspective that economic regulators need to take into account. We operate in the world of today, but we must also have an eye on the future.

Pathways to Obtain Access

Queensland's access regime supports competition, by enabling third parties to access significant infrastructure that cannot be economically duplicated. Three services are declared under the regime:

- Aurizon Network's central Queensland coal network
- Queensland Rail's rail network
- the handling of coal at Dalrymple Bay Coal Terminal by the terminal operator.

As a result, these access providers and access seekers are subject to various rights and obligations under the QCA Act.

Overall, Queensland's access regime assists the negotiation process and seeks to limit unnecessary and expensive access disputes. In doing so, the QCA Act provides guidance in terms of what is reasonable and unreasonable. The objective, ultimately, is for access seekers to obtain access on reasonable terms and conditions.

A declaration triggers two forms of access regulation:

- negotiation–arbitration – the QCA Act imposes an obligation on an access provider to negotiate with access seekers to reach an access agreement; if agreement cannot be reached, the Act allows the QCA to arbitrate and determine the access dispute
- an access undertaking – a service provider may submit an undertaking setting out the terms and conditions upon which access will be provided. A key feature of the Queensland access regime is that it provides for a mandatory submission and approval process for a draft access undertaking.

An approved access undertaking gives providers and access seekers greater certainty than if they rely on QCA arbitration. For example, it assists the negotiation process by reducing the scope for disputes and provides both parties with certainty.

However, the risk always exists of seeking to impose too much certainty by narrowing the matters subject to negotiation. Also, imposing unnecessary prescription can be prone to regulatory error. Therefore, it is necessary to strike a balance. An access undertaking process, if done well, provides a sound basis for structured and efficient negotiation.

The QCA's role in deciding whether to approve a draft access undertaking is different from its role in arbitrating disputes, where the negotiate–arbitrate principle applies. For the QCA to review and approve an access undertaking, it needs to consider a range of statutory factors, as required by the government. It

must have regard to the public interest and the interests of those who are not party to the 'agreed deals' of the overall package.

In the absence of trust and willingness to compromise, parties will not be likely to seek a commercially negotiated outcome without a high level of regulatory oversight or intervention. The QCA's preference is for all parties to reach a consensus with a minimal level of regulatory oversight.

Returning to the analogy of design and construction, the QCA as builder, must execute the architect's vision in the environment it finds itself in. The QCA cannot make parties compromise or force trust amongst them. The evolution of third party access highlights regulatory trends, such as the failure of arbitration alone to resolve access disputes in a timely and efficient way.

For example, in telecommunications, where regulation relied heavily on arbitration, significantly more access disputes have occurred than in other sectors. This suggests that reliance on arbitration alone, particularly where there are vertical integration issues, can accentuate incentives to misuse the regulatory process to delay or deny access.

As such, access undertakings have proven to be a more effective approach in delivering timely access on reasonable terms and conditions, and providing regulatory certainty for access providers and access seekers.

Another recent trend is increased regulatory prescription and codification for certain industries, for example, in electricity and gas regulation.

Ultimately, there is no perfect approach to regulation. But where some form of government-sponsored intervention is needed, the regulator's task is to translate the government's design vision into operational reality.

In Queensland, the access regime applies to access providers where monopolies and users have become more sophisticated in advocating their particular positions during regulatory processes. Where counterparties lack a mutual incentive to reach commercial settlement, the focus can shift to aggressively seeking to influence commercial outcomes within regulatory processes. Unfortunately, this can increase the complexity and adversarial nature of access regulation.

The QCA is agnostic about privatisation and the incentives of maximising shareholder returns. It undertakes its task in the light of the facts before it, not the preferences for making its role easier. Obviously, all businesses have an incentive to maximise profits. For monopolists, in the absence of

regulation, this incentive can promote perverse incentives, such as restricting supply or seeking excess profits, which are not aligned to a competitive market outcome.

Access Regulation – Responding to Challenges

The QCA strategic plan (QCA 2017) outlines its vision to improve the prosperity of Queenslanders by promoting a more competitive economy through efficient and effective economic regulation. That is the QCA's core business, and its approach is about how it can deliver on this vision – the key element a more proactive approach to economic regulation than may have been the case in the past.

Importantly, the QCA now proactively commences draft access undertaking investigations with a consideration of using mandatory processes. These processes provide regulatory certainty to all stakeholders about the process and timing for approving a draft access undertaking. For example, it could be argued that not commencing a mandatory process in the recent Aurizon Network and Queensland Rail processes has contributed to both a delay in those processes and uncertainty.

Excessive delays in making a regulatory decision have adverse consequences and can impose considerable costs, thereby creating an environment in which access seekers and access providers are unable to negotiate access with certainty.

Through the QCA proactively managing regulatory processes, all stakeholders are able to benefit from more predictable and transparent reviews. For example, to promote greater predictability throughout the investigation into Aurizon Network's UT5 undertaking, the QCA has released a Statement of Regulatory Intent (QCA 2016). This statement outlines to all stakeholders how the QCA intends to manage that regulatory process. It sets out how the QCA will deliver decisions within a reasonable timeframe and administer consistent and predictable interactions throughout the regulatory process.

The QCA is also intent on enhancing transparency in its decision-making and providing opportunities for stakeholder collaboration. A number of procedural improvements have been implemented for gathering information, assessing confidentiality claims and delivering timely decisions.

While assessing a draft access undertaking is a resource-intensive and time-consuming process, at the end of the process the pricing parameters and standard access terms are locked in. This enables access seekers to obtain access on reasonable terms and conditions and provides certainty to an

access provider about the terms on which it will be required to provide access.

These reflections follow a busy and productive period in access regulation for the QCA. In 2016-17, the QCA implemented access undertakings for the Dalrymple Bay Coal Terminal (in February 2017) and for Queensland Rail and Aurizon Network (both in October 2016).

Conclusion

Economic regulation is interlinked with opportunity, as it is a way of making markets function better on the back of competitive outcomes.

In Queensland, as elsewhere, economic regulators face many challenges. The policy and pricing issues that economic regulation is meant to find pragmatic solutions for are, in themselves, complex. The regulatory decisions have a significant effect on the state's economy, and the interests of a multitude of stakeholders, including the public, need to be considered thoroughly.

The parties involved in economic regulation – for example, the government, the monopolist, access seekers and access holders – often have diverse objectives and hold strong views. Negotiated outcomes, guided by light-handed regulation, are desirable, and avoiding disputes is in all stakeholders' interest. This is where the regulator has the challenge to keep a balance between providing certainty (for example, by avoiding costly delays) and there being room for negotiation. The regulator has to strive to help stakeholders build and maintain effective relationships. Better communication and cooperation is pivotal.

Another modern-day challenge/opportunity for economic regulators to seize upon, is finding ways to promote productivity-enhancing innovation and technology as part of its goals. These elements have become essential in competitive markets for organisations to survive and grow, and should therefore become part of the mix in economic regulation too.

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Critical Issues in Regulation – From the Journals

Shifting the Dial: 5 Year Productivity Review, Productivity Commission, Inquiry Report No. 84, 3 August 2017.

This report from the Productivity Commission (PC) is the first document of its kind for the PC – an examination of the factors and influences that may affect Australia's economic performance over the medium term, in order to offer advice on where priorities should lie if Australia is to enhance national welfare. The process will be repeated every five years.

The reason for being interested in this subject is that the wellbeing of Australians is substantially and inextricably dependent on persistent growth in productivity. When productivity leaps in Australia, all incomes eventually rise. Productivity improvement also offers benefits outside the scope of economic performance measures. People's average life expectancy at birth has increased by nearly 30 years from Australia's federation in 1901. The PC contends that this is an outcome of innovation and investment in public health, education and research, and the introduction of new technologies to replace outdated technologies.

The PC argues that productivity is most of all about:

- not standing in the way of better investment in workplaces;
- not opposing the research and trialling of new ideas; and
- not defending outmoded regulation that prevents consumers and businesses obtaining access to better services.

The PC further believes that significant gains can be made just by recognising the case for change and embracing it.

The PC believes that, in the period between now and the next of these Reports in 2022, income growth in Australia is likely to be about half of historical levels. The offset to the factors behind this — covered in the first chapter — can only be higher productivity.

It is yet far from being an offset to other influences, and in the absence of a shift in economic approach, it may add to the general slowdown. The PC estimates that, on a business-as-usual basis, productivity growth in Australia is more likely to decrease than increase over the medium term.

For the generation born in 2017, if long-run productivity growth lifts sustainably by 0.5 per cent a year, over their lifetime Australian production per person would be about six times its current size, or

about 50 per cent larger than if productivity remains about average.

Significant opportunities in prospect lie in areas that may not traditionally be associated with productivity: health, education, cities and confidence in institutions. These are central to the PC's Report.

Health and education are expanding their share of the Australian economy. Moreover, they are directly under the control of governments. The PC believes that delivering them much more efficiently, and with a serious focus on what improves outcomes for the users of these services, will 'deliver bigger benefits than even traditional industry reform'.

The PC states that its Report is not a long list of 'must-do' advice. Rather, it is a short list of thematic directions covering actions with the greatest scope for deliverable gains in the medium term.

Governments and commentators should be very wary of the seductive claim that something is well under way already in the areas to which most attention is devoted. The PC's analysis, seen in detail in the sixteen Supporting Papers, is that the 'headline is often not supported by reality'; or has not yet achieved the cooperation of all the necessary participants.

Because cooperation is itself a key theme, the PC proposes a Joint Reform Agenda, as a commitment that restores credibility in government leadership on issues where shared responsibilities are common. Many participants in the Inquiry said that governments themselves — their structures, relationships, incentives and capabilities — are the key impediment to (but could be the crucial catalyst for) essential reform. The PC proposes that the choice is made in favour of being the catalyst.

While such an agenda would ultimately need to be endorsed by a renewed COAG, it should first be developed from this foundation by further negotiation between jurisdictions. A shared agenda should be allowed to arise. The PC states that this is not intended to be a take-it-or-leave-it style Report.

Yardstick Regulation of Electricity Distribution – Disentangling Short-run and Long-run Inefficiencies, Subal Kumbhaker and Gudbrand Lien, *Energy Journal*, 38, 5, 2017, pp. 17-37.

A regulator seeking to use regulatory incentives to enforce competition (enhance performance) will find it necessary to establish a yardstick or benchmark so that it can examine the performance of each business it regulates. The authors of this paper consider a

model that not only establishes a benchmark but also identifies persistent and transient (short-run) inefficiency. Persistent inefficiency might arise because of structural rigidities that cannot be altered in the short run. In response, the regulator must develop strategies to remove structural rigidities, especially if persistent inefficiency is quite high in all businesses. This is because persistent inefficiency cannot be improved in the short run by using 'carrots and sticks'. On the other hand, transient efficiency can be improved by designing proper incentives and punishments. Thus, in the authors' view, the policy implications of improving persistent and transient inefficiencies are different from one-another. Consequently, it is desirable to separate the two so that proper policies can be designed to enhance performance.

To test their model, the authors estimate short-run, long-run and overall efficiency of Norwegian electricity distribution businesses for the period 2000 to 2013. Three panel-data models are considered where business effects are controlled for. However, in only one model are business effects separated from long-run (persistent) inefficiency. Short-run inefficiency is allowed to adjust freely over time for each business. Persistent inefficiency, although it varies across businesses, remains constant over time. The production technology is represented by a translog input distance function (IDF) in all three models. The authors find that returns to scale (RTS) and technical change (TC) are quite robust across the models. However, estimates of long-term and overall efficiency vary substantially across models. Furthermore, the efficiency scores are not correlated significantly across the three models considered.

Compared with the Data Envelopment Analysis (DEA), the four-component Stochastic Frontier model used in this study introduced much more model flexibility in explaining the differences between a business's observed practice and the efficient frontier. The authors therefore suggest that the Stochastic Frontier model should be considered as a benchmarking candidate in the future.

The authors conclude that regulators, both in the electricity distribution industry and elsewhere, should consider separating persistent inefficiency from transient inefficiency in estimating yardstick or benchmark performance. Given that the efficiency estimates vary widely depending on whether transient inefficiency or persistent inefficiency is modelled, the regulator ought to take extra care in using the appropriate model and the correct efficiency measures in practice. This is especially the case when the efficiency measures are used to reward or punish businesses as an incentive for better performance.

There are forty nine references in the list of references, with year of publication ranging reasonably evenly from 1977 to 2015.

The article can be accessed by subscription to *Energy Journal*.

The Changing Nature of the Australian Electricity Industry, Tim Nelson, Stephanie Bashir, Eleanor McCracken-Hewson and Michael Pearce, *Economic Papers*, 36, 2, June 2017, pp. 104-120.

The electricity industry has historically had three supply-chain components: generation (that is, 'power stations'); transmission and distribution (that is, 'poles and wires'); and retail supply (marketing, customer services, risk management and billing). For most of the twentieth century, these functions were aggregated together within vertically-integrated government-owned state electricity commissions.

Competition was introduced into the contestable generation and retail supply-chain components as part of the 1990s 'Hilmer Reform' (National Competition Policy) process. After a century of incremental technological developments, the industry is now being transformed by unanticipated new distributed-energy technologies, and by a global focus on reducing emissions.

Key reforms that are likely to be required include: assessing whether the return on capital provided to network operators is appropriate given changing economic conditions; determining the role of competition in the provision of 'behind-the-meter' energy services; and integration of climate-change policy with wholesale energy market design.

The Australian Government has committed to reduce emissions by 26–28 per cent of 2005 levels by 2030. Given the partial substitution of grid-based power, it will be necessary for policy-makers to consider: whether write-downs of Regulatory Asset Bases of monopoly network providers are necessary; and the appropriate role of monopolists and competitive markets in delivering distributed energy. In relation to climate change, it will be important for policy-makers to utilise the current Finkel review and the 2017 Commonwealth review of climate policy to integrate the electricity and climate-change policy streams. The 'energy-only' market's operation has been altered through the implementation of climate change and renewables policies.

Therefore, it may be necessary to research how the impacts of these policies could be mitigated to ensure emissions reductions occur in an orderly and cost-effective manner.

There are forty-nine items in the reference list. Year of publication ranges from 1949 to 2016. Journals cited most frequently in the reference list include *The*

Electricity Journal, Energy Policy and Energy Economics.

The article can be accessed by subscription to *Economic Papers*.

Spectrum Fees and Market Performance: A Quantitative Analysis, Carlo Cambini and Nicola Garelli, *Telecommunications Policy*, 41, 2017, pp. 355-366.

This paper researches the impact of spectrum fees and spectrum availability on the revenues of mobile operators. It uses an original dataset of businesses operating in 24 countries tracked from 2005 to 2014. Nineteen of the countries are in Europe; three are in Asia (China, India and Turkey); one is in North America (the United States of America); and one is in South America (Brazil). The sample is therefore a mixture of developed and developing (emerging) economies. Explanatory variables include real GDP; total population; urban population; and a measure of market liberalisation. A multiple-regression analysis is used to estimate the model. The main conclusions are that neither spectrum availability nor spectrum fees is significantly correlated with mobile revenue. The authors suggest that 'market expectations to extract additional revenues from the mobile service following new spectrum auctions are likely not to be respected'.

Sections of the paper are as follows: Introduction; Literature review; Industry revenues and the other main variables; Panel description; Empirical analysis; Conclusion and Appendix: Regression diagnostics.

There are twenty-five items in the reference list. Year of publication ranges from 1991 to 2014.

The article can be accessed by subscription to *Telecommunications Policy*.

Light Rail, Land Values and Taxes, Cameron Murray, *The Economic Record*, 93, 302, September 2017, pp. 448-464.

This paper is about the gains in land value that can be attributed to a transport project, and the extent to which these gains can be captured through taxes and other means. The application in this paper is to land-value gains that are attributable to the light-rail system recently built in the Gold Coast, Australia.

Using a panel of statutory land valuations, Cameron Murray presents an empirical model of location-specific gains allowing for price effects at multiple distances from train stations across time. Estimates of the total value gains from the light-rail project to nearby landowners are in the range \$240 million to \$314 million. This is equivalent to around one quarter of the project's total capital cost.

It is contended by the author that the scope to fund transport investment from value gains is apparent.

The Gold Coast City Council levies annual rates on properties and there is also a transport levy. The Queensland State Government has a land tax and also imposes a stamp duty on property transactions. However, in spite of having the administrative structures to recoup funds from the landowners that have benefited from the light rail project, exemptions and budgeting practices mean little is recouped in practice.

There are twenty three items in the reference list with year of publication ranging from 1997 to 2016. Eleven references are dated in the years 2014 to 2016. Sixteen of the references are to articles published in journals specialising in transport and/or urban studies.

The article can be accessed by subscription to *The Economic Record*.

Wholesale Pass-Through Study, Schiff Consulting for the New Zealand Commerce Commission, 21 June 2017.

This study, by Schiff Consulting, of wholesale pass-through was commissioned by the New Zealand Commerce Commission. The aim was to help the Commerce Commission to understand how retailers of telecommunications services have passed through price changes in regulated wholesale copper prices to retail prices charged to residential consumers purchasing fixed-line services. The study looked at a sample of approximately 80,000 residential bills from Spark, Vodafone and Vocus between March 2012 and June 2016.

The study by Schiff Consulting contains an appendix on the economics of pass-through which is based on a 'detailed review' of pass-through economics prepared by RBB Economics for the UK's Office of Fair Trading in 2014. The key results from the theoretical literature that are relevant to analysis of regulated changes in wholesale telecommunications prices are:

The rate of pass-through of changes in marginal cost of an input to changes in prices depends on: the 'curvature' of demand; whether businesses have increasing, decreasing, or constant returns to scale; and the intensity of competition among businesses.

Many theoretical models predict that pass-through is greater if the intensity of competition among firms is greater. However, for some types of demand curvature, pass-through could decrease as competition becomes more intense.

A wide range of pass-through rates are possible even in the extreme cases of monopoly or perfect competition. For example, high rates of pass-through are theoretically profit-maximising behaviour for a monopoly under certain demand and cost conditions. It is even theoretically possible for monopoly pass-

through to exceed 100 per cent. Similarly, pass-through in a perfectly competitive market could be relatively low.

If businesses compete on quality in addition to price, then changes in costs will generally lead to some change in both quality and price. This complicates the relationship between cost changes and price changes, since consumers' willingness to pay for a product depends partly on its quality. Businesses will take this into account when setting prices. It is theoretically possible that a cost reduction could lead to an increase in quality and an increase in price (that is, 'negative' pass-through) if the effect on price alone is considered.

In oligopoly markets, pass-through of industry-wide cost changes that affect all businesses equally is generally expected to be greater than that of business-specific cost changes that affect only one business or a subset of businesses in the market.

These results imply that:

It is not possible to assess pass-through in a market using theory alone, and empirical analysis of changes in costs and market outcomes is necessary.

Empirical estimates of pass-through in a market do not, on their own, provide strong evidence about the intensity of competition in that market, because any given competitive intensity could be consistent with a wide range of pass-through rates. However, analysis of pass-through may be useful for analysis of competition if it is combined with other evidence about competitive intensity.

Some consideration must also be given to changes in quality in addition to changes in price, if quality is an important strategic variable of businesses.

Competition, Vertical Relationship and Countervailing Power in the UK Airport Industry, Anna Bottasso, Martina Bruno, Maurizio Conti and Claudio Piga, *Journal of Regulatory Economics*, 52, 2017, pp. 37-62.

In this paper, the authors study what influences airport pricing decisions. The two main explanatory variables are competition in the airport market (measured using a Herfindahl-Hirschman Index or HHI) and the vertical interactions between airports and airlines. The study features a refined definition of airports' market structure. The empirical investigation is based on panel data of the 24 largest UK airports over 1996 to 2008. The authors find that lower concentration in an airport's catchment area and higher airlines countervailing power are associated with lower aeronautical charges.

The authors draw three main conclusions from their analysis:

First, highly concentrated airport markets are associated with higher aeronautical charges. This lends some support to the argument that joint ownership of airports with overlapping catchment areas (such as the metropolitan areas of Paris, Rome and Milan) should be discouraged, *ceteris paribus*.

Second, the authors' refined definition of concentration at the level of airport catchment area supports the decision of the UK Civil Aviation Authority to eliminate Manchester from the list of regulated airports. Indeed, the large decrease over time of the HHI in the catchment area of Manchester (amounting to about one standard deviation in the sample), should generate sufficient downward pressure on Manchester Airport's aeronautical charges as to make formal price regulation unnecessary. Similarly, the very high levels of concentration observed in the catchment areas of Gatwick, Stansted and Heathrow, in addition to the evidence of positive effects of higher concentration on aeronautical charges, support the Competition Commission's decision to force the break-up of BAA and to rely more on market forces to discipline the levels of aeronautical charges. This result provides evidence in favour of the opinion of scholars (such as David Starkie) who argue that economic regulation is often a second-best solution. Moreover, since economic regulation in the UK effectively implies a form of average cost pricing, regulating charges could induce inefficiently low airport charges, possibly impairing allocative efficiency. In this view, relying on competition between airports accompanied, if necessary, by an unbundling of concentrated ownership at local level, is a relevant policy option.

Third, the empirical results suggest that airlines' countervailing power might be a restraint on airports' pricing power which should be taken into consideration by regulators and antitrust authorities in competition investigations. The lower aeronautical charges associated with stronger countervailing power might not necessarily be transferred to consumers.

There are twenty-nine items in the list of references. Year of publication ranges from 1991 to 2016.

The article can be accessed by subscription to *The Journal of Regulatory Economics*.

The Financing of Investment in Utility Assets, Nikos Zafiris, *Economic Affairs*, 37, 2, June 2017, pp. 197-212.

This article concerns ways to finance investment in 'quasi-public assets', such as those of utilities. Pursuing the principle of charging the user, the author draws analogies with not-for-profit investment dedicated to the service of users. Focusing on intergenerational equity, a typical pattern of intergenerational investment transactions is identified

and proposed as a financing norm. The author's model shows that, while an investing generation will always experience a real resource cost, the burden can be alleviated if all new investment is financed by borrowing. Charges or taxes levied for maintenance and replacement of assets offer scope for improving the intergenerational balance.

A common defence of allegedly high or rising utility prices is the need for investment in the facilities. Short of decisions to subsidise such services, their investment needs are seen as naturally chargeable to the users. There is, however, little differentiation between current and future users. The needs of the latter category are often referred to in a typically unquestioned extension of the user constituency.

The expectation of equitable pricing and investment on the part of a utility is generally the same whether the entity is in government or private ownership. In either case a 'public mission' is attributed to the entity, and this is underwritten under private ownership by the regulatory regime. Although privately-owned utilities are expected to make a profit, the level of profits and prices is supposed to be 'fair' to user constituencies, and utilities are expected to share some of the characteristics of the not-for-profit sector, including charities.

Although utilities' assets are used to provide predominantly private rather than public services, their essential nature, and their provision under government regulation if not government ownership, means they can be characterised as 'quasi-public'.

There are twelve items in the reference list.

The article can be accessed by subscription to *Economic Affairs*.

Do State Reviews of Communications Mergers Serve the Public Interest?, Jeffrey Eisenach and Robert Kulick, NERA for Verizon, October 2017.

This **study** is about the appropriate role of state governments in the United States in the merger review process for communications mergers. It is authored by Jeffrey Eisenach and Robert Kulick of NERA who were retained by Verizon to prepare the study. It is 44 pages in length including title and content pages and an appendix. The authors use the legal system of referencing. There are 122 footnotes.

The authors observe that state reviews of communications mergers have been the subject of what they describe as 'vigorous debate among academics and policymakers'. Supporters of state involvement argue that states may have unique local knowledge of competitive conditions or other comparative advantages which allow them to add value to the enforcement efforts of federal antitrust bodies at the Department of Justice (DOJ), the

Federal Trade Commission (FTC), and the Federal Communications Commission (FCC). On the other hand, critics such as themselves question the benefits of state intervention, and also point to the costs, arguing that state reviews are duplicative, costly, and involve unnecessary delays. Critics also argue that state enforcers face incentives to place parochial political interests ahead of overall consumer welfare or the broader public interest. This leads them to impose merger conditions that benefit narrower constituencies to the detriment of the public at large.

The authors present analysis of data that suggests the concerns of the critics are especially apposite to public utility commission (PUC) reviews of communications mergers; especially when interventions are undertaken by PUCs under a public interest standard in which the merging parties bear the burden of proof. Such interventions frequently delay transactions which have been found by federal authorities to generate public interest benefits, thereby postponing the gains to consumers from these transactions. Furthermore, the authors contend that PUC intervention imposes substantial direct costs on the merging parties (which they contend ultimately are passed on to consumers) and even larger indirect costs in the form of merger conditions. They argue that these conditions, while possibly benefiting the states which engage in beggar-thy-neighbour interventions, harm the overall public interest on a national basis. Finally, the authors conclude that the use of merger reviews by PUCs to impose conditions on businesses offering IP-based services (including conditions specifically relating to broadband) is increasingly at odds with federal policy, which pre-empts such services from state oversight in favour of a uniform national approach.

Regulatory Decisions in Australia and New Zealand

Australia

Australian Competition and Consumer Commission (ACCC)

Licensed Post Offices – Collective Bargaining Authorisation

On 9 November 2017 the ACCC announced it has granted authorisation to the Licensed Post Office Group Ltd, and its current and future licensed post office members, to negotiate collectively with Australia Post.

NBN Wholesale Market – Quarterly Report

On 9 November 2017 the ACCC released its seventh quarterly National Broadband Network Wholesale Market Indicators Report for the period ending 30 September 2017.

Annual Container Stevedoring Monitoring Report

On 1 November 2017 the ACCC released its annual Container Stevedoring Monitoring Report which states that while stevedoring operating profits per TEU (the standard unit of measurement for shipping containers) have risen by over 25 per cent in 2016–17, competition levels are set to increase.

Report on Communications Market

On 30 October 2017 the ACCC published its draft report detailing its market study of the communications sector, which includes 29 recommendations spanning competition and consumer issues in communications markets.

Decision on Mobile Services Market

On 23 October 2017 the ACCC announced it has decided not to declare domestic mobile roaming. It has, however, identified a range of regulatory and policy measures that could improve inadequate mobile coverage and quality of service in regional Australia.

Electricity Report

On 16 October 2017 the ACCC published a preliminary report into the electricity market.

See 'Notes on Interesting Decisions'.

Australian Competition Tribunal (ACT)

See under 'Australian Energy Regulator'.

Australian Energy Market Commission (AEMC)

Review of Regulatory Arrangements for Embedded Networks

On 28 November 2017 the AEMC released a final report recommending new rules and laws to give electricity customers more access to retail competition and consumer protections.

Advice to COAG Energy Council on Strategic Priorities

On 21 November 2017 the AEMC published advice in the development of a strategic energy plan by mid-2018.

Interim Report on Gas Pipeline Review

On 31 October 2017 the AEMC published an interim report for its review of the effectiveness of gas pipeline regulation. A draft report will be published in February 2018 and a final report will be provided to the COAG Energy Council in June 2018.

Australian Energy Market Operator (AEMO)

Market Notifications Explained – What Does a 'Lack of Reserve' Mean?

On 23 November 2017 the AEMO provided the context behind its system of notifications to the public.

Commonwealth Government Announces a National Energy Guarantee

On 17 October 2017, the AEMO's advice to the Federal Energy and Environment Minister was accepted, to establish a National Energy Guarantee.

Australian Energy Regulator (AER)

High Prices in New South Wales Wholesale Electricity Market – Report

On 6 December 2017 the AER published its first report to the COAG Energy Council. Monitoring of the NSW wholesale market will continue during 2018 as part of the AER's first comprehensive review of the national wholesale electricity market, to be released in December 2018. A report into the impacts of the closure of the Hazelwood power station will be released in March 2018.

Retail Energy Market Update

On 1 December 2017 the AER published **retail energy market performance data** for the fourth quarter of 2016-17.

2018 Network Tariffs for Victorian Electricity Customers Approved

On 10 November 2017 the AER approved the **2018 network tariffs** for the five Victorian electricity distributors – AusNet Services, CitiPower, Powercor, Jemena and United Energy.

AER Approach to Setting Victorian Electricity and ACT Gas Network Prices

On 31 October 2017 the Australian Competition Tribunal **confirmed the AER's May 2016 revenue decisions** for the five Victorian electricity distribution networks and ACT gas distribution pipelines, rejecting all grounds of review sought by the businesses.

Final Amended Ring-fencing Guideline

On 17 October 2017 the AER announced an **amendment to the Electricity Distribution Ring-fencing Guideline**, which was first published in November 2016. All electricity distribution businesses are expected to be fully compliant with the Guideline by 1 January 2018.

National Competition Council (NCC)

Competition Law – Harper Reforms Passed

On 18 October 2017, the Competition and Consumer Amendment (Competition Policy Review) Bill was passed in Parliament following recommendations from the 2015 Harper Competition Policy Review.

The amendments to the Competition and Consumer Act 2010 include changes to the National Third Party Access Regime to better target the lack of competition in markets for infrastructure services where third party access is required. It is anticipated that the amendments will come into effect in the coming weeks.

As a result of the legislative changes to Part IIIA, the National Competition Council has commenced updating its publications and guidelines. These will be made available for download in due course: <http://ncc.gov.au/>

Australian Capital Territory

Independent Competition and Regulation Commission (ICRC)

Water and Sewerage Capital Contribution Charge for Icon Water – Final Determination

On 8 December 2017 the ICRC **released** its final determination on the Water and Sewerage Capital Contribution Code proposed by Icon Water.

New South Wales

Independent Pricing and Regulatory Tribunal (IPART)

IPART's WACC Method – Feedback Sought

On 31 October 2017 the IPART **sought feedback** on its standard method for deciding the Weighted Average Cost of Capital (WACC).

Special Review – Compliance and Enforcement Policy

On 30 October 2017 the IPART released its **draft Compliance and Enforcement Policy**. Feedback was required by 27 November 2017.

Submission to National Water Reform Draft Report

On 19 October 2017 the IPART **responded** to the Productivity Commission's National Water Reform Draft Report.

Northern Territory

Utilities Commission

Review of the Access and Pricing Regime for the Port of Darwin

On 13 November 2017 the Utilities Commission announced it will release an issues paper in January 2018, followed by a draft report in June 2018, in its **review of the access and pricing regime for the Port of Darwin**. A final report is anticipated by 16 November 2018.

Queensland

Queensland Competition Authority (QCA)

Bulk Water Prices in South-east Queensland 2018-21 – Draft Report

On 7 December 2017 the QCA **published** its draft report recommending bulk-water prices for south-east Queensland for 2018-2021.

South-east Queensland Retail Electricity Market – Monitoring Report Released

On 30 November 2017 the QCA **released** its first monitoring report for the south-east Queensland retail electricity market.

South-east Queensland Solar Feed-in Tariff Report 2016-17

On 20 October 2017 the QCA released its first annual report into solar feed-in tariffs in south-east Queensland.

South Australia

Essential Services Commission of South Australia (ESCOSA)

Ports Monitoring Report 2017 Released

On 30 November 2017 the ESCOSA **released** its Ports Monitoring Report 2017.

SA Water Regulatory Determination 2020 – Draft Framework and Approach

On 23 November 2017 the ESCOSA announced it was seeking feedback on its proposed **Framework and Approach for the SA Water Regulatory Determination** to apply from 1 July 2020 to 30 June 2024.

Strategic Direction Consultation Paper

On 10 November 2017 the ESCOSA announced that it had received three submissions in response to the 6 October 2017 release of a **strategic direction consultation paper for 2018–2021**.

2017 Ports Access and Pricing Review – Price Determination

On 11 October 2017 the ESCOSA **released a price determination** enabling the existing ports price monitoring arrangements to continue from 31 October 2017 to 30 October 2022. The recommendations within the price determination were accepted on 20 October 2017 by the Minister for Transport and Infrastructure.

Tasmania

Office of the Tasmanian Economic Regulator (OTTER)

TasWater Water Price Investigation – Release of Draft Report

On 30 November 2017 the OTTER **released its draft report** on TasWater's price and service levels for the regulatory period from 1 July 2018 to 30 June 2021.

Victoria

Essential Services Commission (ESC)

2018 Water Price Review

On 23 November 2017 the ESC launched a review of prices that 17 Victorian water businesses propose to charge from 1 July 2018. **The review is undertaken under the new water pricing approach.**

Port of Melbourne – Tariff Compliance Statement

In November 2017 the ESC published commentary on the first tariff compliance statement received from the Port of Melbourne in May 2017. **Read about the legislated pricing order.**

Energy Market Hardship Programs – Report

On 21 November 2017 the ESC announced new rules will take effect in January 2019 requiring retailers to provide timely, flexible and meaningful assistance to customers who are facing payment difficulty. This follows the 10 October 2017 final decision on the new framework. **Read the report.**

Western Australia

Economic Regulation Authority (ERA)

Inquiry into the Efficient Costs and Tariffs for Water – Final Report Published and Tabled in Parliament

On 30 November 2017 the ERA **published its final report** on the Inquiry into the Efficient Costs and Tariffs for Water, applying to the Water Corporation, Aqwest and Busselton Water.

Proposed Revisions to the Western Power Network Access Arrangement 2017-18 to 2021-22

On 14 November 2017 the ERA published the revenue model underpinning **Western Power's proposed revisions to its access arrangement**.

2017 Weighted Average Cost of Capital

On 6 October 2017 the ERA announced the weighted average cost of capital (WACC) for the Public Transport Authority, Arc Infrastructure, The Pilbara Infrastructure (TPI) and the Roy Hill Infrastructure (RHI) railways, as at 30 June 2017, as required by the Railways (Access) Code 2000. **Read about the calculation of the railway network WACCs.**

Rate of Return Guidelines for Gas Transmission and Distribution Networks – Review

On 3 October 2017 the ERA announced commencement of a review of the rate of return guidelines that apply to regulated gas networks and transmission pipelines in Western Australia. **Final updated rate of return guidelines are anticipated in March 2018.**

Approval of 2017 Energy Price Limits

On 28 September 2017 the ERA approved the **Australian Energy Market Operator's proposed energy price limits**.

Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and Busselton Water (2016)

On 22 September 2017 the ERA published submissions in response to its draft report. **A final report was anticipated by 10 November 2017.**

New Zealand

New Zealand Commerce Commission (CCNZ)

Major Telcos Contribution to \$50 million Development Levy – Draft Decision

On 7 December 2017 the CCNZ **released its final decision** on how much 16 telecommunications providers will each pay towards the Government's \$50 million Telecommunications Development Levy (TDL) for 2016-17.

Review of Rules for Transpower's Investment in National Grid – Draft Decision

On 15 November 2017 the CCNZ released its **draft decision on its review of the rules relating to Transpower's capital expenditure**. Feedback was required by 8 December and a final decision is anticipated by the end of March 2018.

Information Requirements on Gas Companies Seeking Customised Price-Quality Paths – No Change Proposed

On 24 October 2017 the CCNZ **released a draft decision** which proposes not to amend the information requirements applying to gas pipeline businesses which apply for a customised price-quality path (CPP).

Review of Auckland and Christchurch Airport Prices – Process and Issues Paper Released

On 20 October 2017 the CCNZ released a **process and issues paper** for its review of the prices Auckland and Christchurch International Airports have set to apply for the period 1 July 2017 to 30 June 2022.

Fonterra's 2017-18 Milk Price Manual – Draft Report

On 13 October 2017 the CCNZ released its **draft report on its annual review** of Fonterra's Milk Price Manual for the 2017-18 dairy season. Feedback was required by 15 November 2017 and the final report will be published by 15 December 2017.

Electricity Lines Companies – Annual Performance Summaries Released

On 4 October 2017 the CCNZ published its latest one-page summary of key performance measures for each of New Zealand's 29 electricity lines companies, **covering the year to 31 March 2017.**

Notes on Interesting Decisions

The ACCC's Retail Electricity Pricing Inquiry – Preliminary Report

On 16 October 2017 the ACCC published its **preliminary report** on the retail electricity market following a direction on 27 March 2017 from the Treasurer to hold an inquiry into the retail supply of electricity and the competitiveness of retail electricity markets in the National Electricity Market (NEM). The ACCC's terms of reference for the Inquiry are broad, encompassing all levels of the electricity supply chain.

The NEM is the wholesale electricity market that covers Queensland, New South Wales, Victoria, South Australia, Tasmania and the Australian Capital Territory. As both Western Australia and the Northern Territory are not connected to the NEM they are not included in the Inquiry.

The ACCC received information, documents and data from industry participants and a range of other interested parties, including consumers, businesses, representative groups and other government and non-government organisations. It received over 150 submissions to its Issues Paper released in May 2017 and spoke directly with consumers and businesses at public forums in Adelaide, Brisbane, Melbourne, Sydney and Townsville.

The ACCC concluded from this consultation and information gathering that (i) there is a severe electricity affordability problem across the NEM; and (ii) that price increases over the past ten years are putting Australian businesses and consumers under pressure.

The ACCC found that retail electricity prices significantly increased in the past decade, and an increasing number of consumers reported difficulties meeting their electricity costs. According to the ACCC, some consumers have been forced to minimise their spending on other essential services, including food and health services, to afford electricity bills.

The ACCC also concluded that businesses across all sectors have faced even higher increases over the past twelve months, following renegotiation of long-term contracts. The ACCC found that many of these businesses cannot pass on the increased costs, and are considering reducing staff or relocating to other countries. Some businesses have been forced to close.

The ACCC has found that there is insufficient competition in the generation and retail markets, which both raises prices and increases barriers to entry. It also found that retail price deregulation has benefited some and hurt others. The market is exceptionally complex, and consumers have no ability to exit the market.

This preliminary report outlines the ACCC's findings from the initial stage of the Inquiry. The ACCC has analysed each of the key components of a retail electricity bill to demonstrate what has driven price increases over the past decade. It has also looked closely at the operation of each level of the electricity supply chain, identifying issues around market structure and firm behaviour. A particular focus of the ACCC's work has been to explore the operation of the retail electricity market to identify the key barriers that consumers face in accessing competitively priced electricity, including challenges in engaging with electricity retailers and choosing the electricity service that is best. The preliminary report concludes by setting out the ACCC's agenda for the remainder of the Inquiry.

Regulatory News

2018 ACCC & AER Regulatory Conference

The 2018 ACCC/AER Regulatory Conference will be held at the Brisbane Convention and Exhibition Centre, Queensland, on Thursday 26 and Friday 27 July 2018. Details about the conference and how to register will be posted on the ACCC's webpage in March 2018.

Network is a quarterly publication of the Australian Competition and Consumer Commission for the Utility Regulators Forum. For editorial enquiries please contact Rob Albon (Robert.Albon@acc.gov.au) and for mailing list enquiries please contact Genevieve Pound (Genevieve.Pound@acc.gov.au).