3 Structural reform of public monopolies

The protection of some public monopolies from competition through regulation or other government policies has allowed structures to develop that do not readily respond to market conditions. Rectifying strategies include removing the relevant legislative restrictions and applying competitive neutrality principles. These strategies, however, will not always be sufficient to establish effective competition. Structural reform may be needed to dismantle an integrated government monopoly business. Such reform involves splitting the monopoly (or parts of it) into smaller entities, including separating the competitive or potentially competitive elements from the monopoly elements.

Structural reform is particularly important where a public monopoly is to be privatised. Privatisation without appropriate structural reform is likely to result in a private monopoly supplanting the public monopoly with few real gains and potentially considerable risks. Clause 4 of the Competition Principles Agreement sets out obligations relating to the structural reform of public monopolies. Under this clause, governments agreed to relocate regulatory functions away from a public monopoly before introducing competition to the market served by that monopoly. The aim is to prevent the former monopolist from enjoying a regulatory advantage over existing or potential competitors.

Clause 4 also sets out review obligations aimed at ensuring reform paths lead to competitive outcomes. Before privatising a public monopoly or introducing competition to a sector supplied by a public monopoly, governments have undertaken to review:

- the appropriate commercial objectives of the public monopoly
- the merits of separating potentially competitive elements of the public monopoly from the natural monopoly elements and into independent competing businesses
- the best way of separating regulatory functions from the monopoly's commercial functions
- the most effective way of implementing competitive neutrality
- the merits of any community service obligations provided by the public monopoly and the best means of funding and delivering them
- price and service regulations to be applied to the relevant industry

- the appropriate financial relationship between the owner of the public monopoly and the public monopoly.

In its National Competition Policy (NCP) assessments, the National Competition Council has considered each jurisdiction's structural review and reform activity (including the location of industry regulation) where competition is introduced to public monopoly markets or where privatisation is proposed or under way. The Council previously determined that the relevant jurisdictions met their clause 4 obligations in relation to:

- the statutory dairy authorities in all states and the ACT
- the Queensland Sugar Corporation
- the rail sector in New South Wales, Western Australia and Victoria
- port authorities in New South Wales, Victoria, Queensland, Western Australia, South Australia and Tasmania
- the Sydney basin airports (an Australian Government matter).

Areas previously determined to not comply with clause 4 obligations relate to AWB Limited and Telstra. Information on these Australian Government areas is provided below.

In this 2004 NCP assessment, the Council considered the structural reform of Western Power, the public monopoly in the Western Australian electricity sector. A summary of progress is provided below, with more detailed information provided in chapter 6.

Western Power

In the 2003 NCP assessment, the Council noted the government's endorsement of the Electricity Reform Task Force's recommendations, including the following relating to the state's CPA clause 4 obligations:

- the vertical disaggregation of Western Power into generation, networks and retail entities in the South West Interconnected System, and a regional power entity in the North West Interconnected System and non-interconnected systems, by 1 July 2004
- the development of an Electricity Access Code by 1 January 2004 and the operation of the new access framework and licensing regime by 1 January 2005.

The *Electricity Industry Act 2004* implements several task force reforms, providing for the development of a wholesale market in the south west of the state, an independent licensing regime for electricity industry participants, a third party access code and consumer protection measures. The wholesale market is expected to commence in July 2006. The independent Economic

Regulatory Authority commenced on 1 January 2004 and will administer the electricity licensing regime. The establishment of the independent regulator is consistent with Western Australia's obligations under the CPA clause 4(2) which requires a government to remove responsibilities for industry regulation from a public monopoly before introducing competition to a sector traditionally supplied by the monopoly.

However, the government has not disaggregated Western Power into generation, network, retail and regional entities. The task force considered such disaggregation to be a central reform. CPA clause 4(3) requires governments, before introducing competition to a market supplied by a public monopoly, to review the merits of separating natural monopoly elements. Chapter 6 discusses the implications of Western Australia's non-introduction of disaggregation for the state's adherence to CPA clause 4.

AWB Limited

In early 2000, the Australian Government commissioned a three-member committee to review the *Wheat Marketing Act 1989* against CPA clauses 4 and 5 and other policy principles. In relation to the structural reform obligation under CPA clause 4, the committee found that the Act does not clearly separate the regulatory and commercial functions of AWB Limited (the former Australian Wheat Board). It recommended that the Australian Government amend the Act to:

- ensure the Wheat Export Authority (WEA) is totally independent
- allow, for the three years until the 2004 review, the WEA to consent to the export of:
  - wheat in bags and containers without consulting AWB International (AWBI) Limited
  - durum wheat without obtaining the AWBI's written approval.

The Australian Government responded in April 2001 but declined to amend the Act to ensure the independence of the WEA, particularly in relation to the export consent arrangements. It argued that removing the AWBI's role in these arrangements would significantly change the balance between the operations of the WEA and the AWBI, which might have affected the AWB Limited's then proposed listing on the Australian Stock Exchange. In the Council's view, these arguments are not sufficient to underpin the Australian Government's failure to conduct a CPA clause 4 review before privatising the former Australian Wheat Board. In the 2003 assessment, therefore, the Council found that the Australian Government had not met its CPA clause 4 obligations.

On 15 October 2004 the independent panel appointed by the government to review the wheat export marketing arrangements released a summary report

of its findings and recommendations — the 'Growers' Report'. The terms of reference of the review limited it to assessing the AWBI's performance as the manager of the wheat export 'single desk', its conduct in relation to consents by the WEA to wheat exports by other parties, and the WEA's performance of its functions under the Act. The terms of reference specified that:

> *Analysis of whether or not the single desk should continue is not within the scope of the review and the review is not intended to fulfil National Competition Policy requirements.* (Truss 2003)

Further, in relation to bulk wheat export consents, the panel did not examine options for removing the veto power of AWBI, arguing that this is intrinsic to the single desk system. However, it recommended that the AWBI and WEA ensure greater transparency and accountability in the exercise and monitoring of this power. In particular it recommended that AWBI provide more explicit explanation to exporters on any decision to veto a bulk export application. The Australian Government has indicated it will respond to this and other recommendations of the review by late 2004.

Nevertheless, the incomplete nature of the review means the Council is still unable to assess the Australian Government as having met its CPA clause 4 obligations.

Telstra

Legislation in 1997 and 1999 provided for the part privatisation of Telstra which triggered commitments for the Australian Government under CPA clause 4 to review 'the merits of separating natural monopoly elements from potentially competitive elements of the public monopoly' before privatising a public monopoly. In regard to this obligation, the Council reported in its 1999 NCP assessment that:

> *This examination should have been undertaken prior to the partial privatisation and should have involved considering the merits of structurally separating the local fixed network from the non-monopoly elements of Telstra's business, or alternatively, arrangements for ring-fencing the local fixed network and Telstra's business units.* (NCC 1999, p. 338)

The Australian Government advised the Council that it considered that it had satisfied this requirement through related reviews. Moreover, it contended that it preferred, rather than pursuing structural separation, to prohibit anticompetitive conduct through part XIB of the *Trade Practices Act 1974* and to facilitate access to telecommunications services under Part XIC of that Act.

In 2000, the Australian Government asked the Productivity Commission to review telecommunications regulation, but instructed it not to inquire into options for the structural separation of Telstra. The Commission made recommendations to improve the efficiency of the regime regulating access to

the telecommunications network. Taking account of these recommendations, the Australian Government made legislative changes requiring Telstra to prepare separate accounts for its wholesale and retail operations. Accordingly, the Australian Competition and Consumer Commission introduced changes to the record-keeping rules that it applies to major telecommunications companies, to complement the introduction of accounting separation by Telstra. These reforms somewhat mitigate the concerns about the market power of Telstra.

Through the Productivity Commission review and subsequent legislative changes, the Australian Government has made efforts to meet its NCP obligations relating to the partial and potential full privatisation of Telstra. Nevertheless, the Council remains of the view that the government, to have complied with its obligations under the CPA, should have considered the structural separation of the network in a formal way.