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COMPETITION POLICY, INDUSTRIAL POLICY AND NATIONAL CHAMPIONS

Contribution from Papua New Guinea

-- Session I --

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COMPETITION POLICY, INDUSTRIAL POLICY AND NATIONAL CHAMPIONS

--Papua New Guinea--

1. Introduction

1. Papua New Guinea (PNG) has been an independent nation since 1975. For many years it was thought that the economy had not developed enough to warrant competition law. There was some limited consumer protection law and price control. Furthermore with most utilities being provided by the national Government time was not ripe for competition law. Industry was largely Government run or controlled.

2. However with the move to privatisation of some utilities and the development of the PNG economy competition law was introduced. That process commenced in 1996.

3. Competition Policy and Industrial Policy became part of the same goal, economic efficiency and consumer welfare.

4. The policy was to open up markets to imports, foster exports and generally encourage competition. Industries that lacked competition were subject to regulation by the competition regulator, including price control in some limited circumstances.

5. In 2002 the PNG Parliament enacted the Independent Consumer and Competition Commission Act 2002. It created the Independent Consumer and Competition Commission (ICCC). The ICCC, the consumer protection provisions and the regulatory provisions came into effect on 16 May 2002. The competition provisions did not come into effect until 16 May 2003.

6. The competition provisions, referred to as the Market Conduct Rules, are based on those in the New Zealand Commerce Act and are similar to the competition provisions applying in most developed economies. Broadly speaking, the Market Conduct Rules prohibit arrangements which substantially lessen competition (with a per se prohibition of price fixing); resale price maintenance; exclusionary conduct (primary boycotts); and misuse of market power (abuse of dominant position). Anti-competitive mergers or acquisitions are also prohibited. Authorisation by the ICCC on public benefit grounds can be applied for – a small number of authorisations on public benefit grounds have been approved by the ICCC since 2003 for business acquisitions or for anti-competitive arrangements.

7. The law is tailored to meet PNG needs. In particular there are provisions regulating PNG’s monopoly (government owned) utilities. There is also provision for price control, though the number of products which are currently subject to price control or price monitoring is very few.

8. In effect the ICCC Act has an overall competition and consumer protection mix. In addition the Act has some unique provisions relating to essential utilities which affect the bulk of PNG consumers.

2. Clearance and authorisation.

9. The Act provides for both clearance and authorisation in relation to mergers and has set time limits for both. In relation to clearance the ICCC has to make its decision within 20 days, in relation to authorisation it is 72 days. [Clearance is where the ICCC is requested to declare whether or not a merger may result in a substantial lessening of competition. Authorisation is where a merger or acquisition which would or might substantially lessen competition, and thus be in breach of the law, can be exempted on public benefit grounds.]

10. Authorisation (but not clearance) is also available for conduct which would otherwise be prohibited by the other competition provisions of the Act, except for taking advantage of market power (abuse of dominant position) which cannot be authorised. In a small non trade exposed economy such as PNG there is a very high likelihood that many mergers will substantially lessen competition. Further, conduct such as resale price maintenance and exclusive arrangements that have no doubt been prevalent in PNG for many years are now either clearly unlawful or potentially unlawful.

11. The clearance and authorisation processes allow other factors and policies to be taken into account when considering competition issues, including industry policy.

3. Regulatory and price control provisions of the ICCC Act

12. In addition to its functions in administering competition law, the ICCC has other industry regulatory and price control roles.

13. PNG industry regulatory framework relates specifically to government owned monopoly utilities, where there is a “regulatory contract” between each of the utilities and ICCC (on behalf PNG consumers), which sets a price path for the monopoly services provided by that utility, going forward into the medium to long term future, as well as setting out required service quality standards,. Those regulatory contracts with the ICCC exist in relation to electricity, water, ports, telecommunications and postal services.

14. The regulatory contracts are developed and enforced and reviewed by the ICCC. The contracts relate to pricing, service standards, innovation, capital expenditure plans and increased efficiencies.

15. Price control has been rolled back in recent years but still applies to some basic commodities used by PNG citizens. For example price control or price monitoring exists in relation to fuel, public transport services, rice and flour.

16. In addition to its regulatory contracts and price regulation functions, the ICCC conducts regular reviews of sectors of PNG industry and advises the Government on possible changes to regulation or policies generally in those industries. Recent reviews include petroleum, coastal shipping, tourism, general insurance, and the water and sewage industries. Through these reviews, the ICCC’s views on competition policy can be injected into the debate on industrial policy in these industries.

4. The ICCC

17. The ICCC is the only national regulatory body that acts as a consumer and business watchdog. The provisions of the ICCC Act apply to all businesses in Papua New Guinea including government enterprises. The ICCC Act also applies to conduct outside PNG which affects the PNG market.

18. The ICCC was set up to be independent from government interference or pressure from individual Ministers or politicians, in recognition of the importance of the industry regulator having integrity and a totally professional and objective approach to its tasks, protected from outside influence. This was seen as being particularly important in the PNG environment where, as with many developing countries, corruption and lack of transparency in decision making have been major impediments to business confidence – particularly so where PNG has in recent years received an adverse rating from Transparency International on its worldwide corruption index – 161st out of 179 countries.

19. To ensure this independence and integrity, the Commission consists of a full time Commissioner and two part time Associate Commissioners, all of whom are appointed by a committee which includes both the Prime Minister and the opposition leader. One Associate Commissioner position is allocated to an overseas industry regulation expert. Commissioners, who are appointed for five years, are protected

against arbitrary dismissal by having, in effect, the tenure of a senior judge. In addition, the ICCC Act expressly provides that the Commission is not subject to direction or control by a Minister or anyone else in the performance of its functions, except for certain specific, publicly notified directions.

20. In performing its functions and exercising its powers under the ICCC Act, the ICCC is required to have regard to the following primary objectives:

- to enhance the welfare of the people through the promotion of competition and fair trade and the protection of consumers' interests;
- to promote economic efficiency in industry structure, investment and conduct; and
- to protect the long term interests of the people with regard to the price, quality and reliability of significant goods and services.

21. The ICCC Act also gives the ICCC a number of facilitating objectives:

- to promote and protect the bona fide interests of consumers with regard to the price, quality and reliability of goods and services;
- to ensure that users and consumers (including low-income or vulnerable consumers) benefit from competition and efficiency;
- to facilitate effective competition and promote competitive market conduct;
- to prevent the misuse of market power;
- to promote and encourage the efficient operation of industries and efficient investment in industries;
- to ensure that regulatory decision making has regard to any applicable health, safety, environmental and social legislation; and
- to promote and encourage fair trading practices and a fair market.

22. These primary and facilitating objectives require the ICCC to focus on industrial policy in carrying out its functions, and thus gives the ICCC a central role in the administration of industry policy.

5. Interaction between the ICCC's promotion of competition, and its regulatory roles

23. The ICCC's primary objective is the enhancement of consumer welfare, while the protection and promotion of competition is one means towards achieving that end. PNG is a small economy and competition is not always possible but consumer protection is essential. There may be circumstances where price regulation or other government intervention is needed to protect consumers and make sure that they have access to best value goods and services.

24. The competitiveness of a market affects the level of consumer protection required. In PNG we strive for competitive and informed markets but that is not always possible and hence substantial reliance on regulatory and price controls.

25. In circumstances where there is little or no competition in the market (e.g. in a natural monopoly situation such as a telephone or electricity utility, and particularly in small economies that tend to have less competitive markets) there may be greater justification for intervention to ensure that consumer welfare is maintained because competition is not driving the market.

26. In short, the amount and type of regulation there should be to ultimately benefit consumers will depend on the competitiveness of markets. In highly contested markets, regulation should be only introduced with great care, while in markets where there is little or no contestability, some form of regulation may be more readily justified. That regulation may extend, in some cases, to price regulation or price control for particular commodities or services, where market forces alone cannot restrain prices, even though price control is, in one sense, the antithesis of competition regulation.

27. Given the high degree of interaction between the two policies, it is not possible to determine competition law policies and consumer protection policies in isolation. It is not only possible, but necessary, to administer these laws in harmony to achieve the ultimate goal of consumer welfare.

6. Importance of competition policy to a small economy

28. Competition policy, which is appropriately designed and effectively enforced, can be more important in small economies than in larger ones.

29. Small economies can support only one or two competitors in many industries, because of the small size of the markets. Openness to trade is a good solution to many of the problems of small size, because it enlarges the market, but competition policy also plays a crucial role in regulating market activity; it helps trade by reducing barriers to both foreign importer entry and domestic product exports; it plays a critical role where exposure to international trade is not sufficient to solve a small economy's efficiency problems; and where artificial trade barriers (such as tariffs) are not reduced, competition policy is an alternative for regulating 'closed' small markets. In this sense, competition policy is a subset, or an integral part, of industry policy.

30. However, since competition policy is adopted to address various failures of the market, the policy should be carefully designed to deal effectively with the unique obstacles to competition that are present because of the small size of the economy.

31. The main goal of competition policy in small economies should be to promote efficiency. But when considering competition policy for small economies you are faced with a dilemma.

32. On the one hand, large firm or plant size may be required in order to achieve efficient scales of production, so it may be that only one or two firms can operate in an industry in order to achieve efficiency.

33. But on the other hand, the high level of concentration, or even monopoly control, of a market that results can lead to certain types of industry behaviour that is very damaging to efficiency.

34. The case studies on national champions, set out below, demonstrate how this damage can occur unless it is carefully managed.

7. Industry Policy issues - interaction and conflict with competition law

7.1. Protectionism

35. Starting in 1999, significant unilateral trade liberalisation began in PNG under the Tariff Reform Program. Most imports (about 75% in value) enter duty free. Tariffs are applied to those products that are made, or could be made, in PNG. Rates on these imports have declined by 5% in each of January 2001, 2003 and 2005 to their current rates of 40%, 25% and 15% for the prohibitive, protective and intermediate product rates respectively.

36. PNG has no antidumping, countervailing duty or safeguard mechanisms (trade remedy instruments). Some manufacturers, feeling the effect of the Tariff Reform Program, are urging the PNG government to legislate for such trade remedy instruments. PNG's Import-Export Impediments Subcommittee has been specifically requested to address, and potentially prepare legislation and procedures, for the trade remedy instruments. It is possible that unless some reasonable trade remedy instruments are designed, legislated and enacted, future Tariff Reforms will be stalled. Some PNG negotiators consider trade remedy instruments necessary before considering future cuts.

37. PNG has entered into FTA agreements with the Pacific (Pacific Island Country Trade Agreement and sub regionally with the Melanesian Spearhead Group Trade Agreement) and the EU. The latter being part of the EU's EPA initiative for the Pacific ACP countries (PACPs). An interim agreement has been initialled and a comprehensive agreement including services and development issues are to be negotiated. The latter may include a competition law provision.

38. The entry into the above FTAs has triggered Article 6 of the Pacific Agreement on Closer Economic Relations (PACER) agreement which requires the Pacific states to commence negotiations for a full FTA with Australia and New Zealand. Australia has indicated their desire to enter into these PACER+ negotiations. Australia is the exporter for 56% of PNG's imports. If negotiated, PACER+ will have significant implications.

39. The likely precedent to be used in the PACER+ negotiations will be the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZERTA). ANZERTA has one of the strongest set of competition law provisions of any regional trade agreements. We understand that the competition law provisions go beyond co-operation and comity issues and require competition principles to be used in applying trade remedy instruments.

40. Generally speaking, both trade remedy and competition policy legislation and application has been prone to regulatory capture by protectionist influences, industrial policy advocates and self-interest groups. With PNG looking for rapid industrial and resource development, this is potentially a minefield for PNG's competition, trade and investment liberalisation objectives. Some potential investors in PNG have taken advantage of PNG's situation of a small and underdeveloped economy needing to develop its industrial base, combined with PNG's relatively high perceived sovereign risk, to extract concessions and competition advantages from the government including tax holidays, import protection, and short or long term monopoly rights, as conditions required before the new investment will be made. Successive governments have felt obliged to accede to these demands, being concerned that the investments will not go ahead without it. Some instances of this can be seen in the case studies on national champions.

8. National Champions

41. Since independence in 1975, PNG has had a policy of supporting some national champions which are seen as of strategic importance to the national economy or to the effective operation and development of infrastructure. However, this is a relatively limited policy; PNG does not have any

significant number of statutory monopolies (though the size and nature of its economy means that there are many areas of natural monopoly) and the statutory monopoly protection or statutory market preference which does apply, has been diminishing in recent years.

42. This diminution is due to the introduction of general competition law and industry regulation in 2002 through the ICCC Act, described earlier. The general competition law (market conduct rules) in the ICCC Act have universal application across all industries in PNG, and also apply to government insofar as it carries on a business. There is provision for exemption from the application of the Act to acts which are specifically authorised by legislation, though such instances are rare.

43. More particularly, when competition law was introduced in 2002, the statutory frameworks supporting major utilities (such as electricity, water, telecommunications, ports and harbours and the like, which had until then been government owned and run state monopolies), were changed to allow competition in those industries, with a licensing regime for both the existing monopolists and any new competitors. Those utilities had by then been corporatised with the intention of their being privatised, though that privatisation has not generally occurred.

44. However, while competition is now permitted in most of these utility sectors, some of the utilities retained some statutory monopoly positions, at least for a limited time. As explained earlier, the utilities regulatory framework involves the ICCC setting long term price paths and service quality standards for the monopoly activities of these utilities, either through the ICCC Act or through price regulation under the Prices Regulation Act. Thus some of the utilities can be regarded as "national champions" because of their strategic importance to the national economy and social structure.

45. With the utilities reforms of 2002 it was intended that the statutory monopoly protection which the utilities retained, would be reduced over time until that protection was fully removed and those markets became fully competitive. It was hoped that at that stage the special regulatory arrangements regulating consumer price paths and specifying service quality standards may also be able to be removed, with regulation of prices and service quality for utility industries being driven by market forces and the general application of competition law.

8.1. Telikom PNG Limited

46. The best example of what has occurred since 2002 with utilities regulation and the continued protection of national champions in PNG is in the telecommunications sector, with Telikom PNG Limited (Telikom).

47. Telikom (originally the Postmaster General's Department) was, in 2002, the sole licensed operator for fixed lines and also the sole licensed mobile (cell phone) operator. When the 2002 reforms were introduced, Telikom's existing statutory monopoly was expected to continue for five years, ending in 2007. This monopoly was secured by the ICCC being prevented from issuing any competing fixed line carrier or mobile carrier licences until October 2007. It was anticipated that by that time, Telikom should have developed and improved its business and services to a point where it would be able to effectively compete with other mobile and fixed line operations, which would then be licensed to develop and operate new mobile and fixed networks in open competition with Telikom. It was felt that that five years' additional protection from competition for Telikom, until 2007, should have been sufficient to protect Telikom, as a national champion, to allow it to then operate successfully in a competitive environment.

48. In December 2005, Government Policy changed, to require the introduction of two new competitors to compete with Telikom in mobile telephones after March 2006, while Telikom's monopoly in fixed lines was to remain until October 2007. There is now active and vigorous competition between

Telikom and Digicel in the mobile market (the second new competitor not yet having commenced operations). However, attempts were made in 2006 and 2007 by some in government to reinstate Telikom's monopoly in mobiles as well as fixed lines, on a permanent basis. These moves, which were strongly criticised at the time by the business and wider communities in PNG, were not successful in preventing Digicel from competing with Telikom in mobiles. However, Government Policy was changed in 2008 to, in effect, continue Telikom's monopoly over fixed lines beyond 2007, and to legislate Telikom's monopoly over international gateways (and thus monopolise all international telephone business) for an indefinite period until full competition is achieved.

49. This change in policy was explained as being necessary to enable Telikom, as the national champion in telecommunications, to continue to receive monopoly rents from fixed line and international telecommunications, to enable Telikom to transform itself into a strong and effective competitor. The Government has said that this is stage one of a two stage process leading towards open competition in international markets and, presumably, in all other areas including fixed lines. The Government has committed to the European Union that stage two, open competition (in international gateways at least), will occur during 2009.

50. Thus the national champion in telecommunications, Telikom, is continuing to receive government monopoly protection in fixed lines and international, though with the stated objective of moving into a fully open competitive environment in the future.

8.2. PNG Power Limited

51. The only other utility which has statutory monopoly protection is PNG Power Limited, formerly the Electricity Commission, though only in a limited way. Since 2002, persons operating electricity generation, transmission, distribution and retailing businesses have been required to be licensed by the ICCC and can operate in competition with each other. PNG Power has licences for each of those four activities. However, its electricity retailing licence is a monopoly in respect of those places which were supplied retail electricity by PNG Power in 2002 and which are still being supplied by it. In new areas for supply, PNG Power does not have any monopoly rights.

52. Thus electricity generation, transmission and distribution are fully competitive (though few licences have been requested or issued to anyone other than PNG Power), while PNG Power retains its retailing monopoly in those areas which it serviced prior to 2002, and new service areas are also open to retail competition.

53. There are no statutory monopolies for other utilities, though some retain effective natural monopolies.

8.3. Air Nuigini Limited

54. Air Nuigini, which is government owned, originally had an effective monopoly over scheduled air services domestically and internationally. For several years, Air Nuigini has faced competition on domestic routes from privately owned competitors, principally Airlines of PNG Limited, and in the last year or so Airlines of PNG has been competing with Air Nuigini on some international services. There are no statutory or legislated monopoly rights for Air Nuigini.

55. However, in recent months, the government, in promoting Air Nuigini as the national carrier, and in effect a national champion, has provided financial assistance to Air Nuigini on non-commercial terms, including by way of non-repayable grants, to enable Air Nuigini to purchase additional aircraft and, in at least one instance, giving a grant to allow Air Nuigini to continue to operate a seriously loss making international route.

56. While Air Nuigini enjoys no special statutory advantages over its competitors, the financial assistance given by the government to its national champion, air Nuigini has the capacity to distort competition in PNG's domestic and international airline markets.

8.4. Major Oil and Gas Projects

57. There have been instances where the Government has chosen national champions for special treatment or exemption from competition laws, as an inducement to the development of projects in PNG involving oil and gas. In 1997, the then government agreed, as part of an arrangement for the construction of an oil refinery in PNG, to ensure that the refinery operator, InterOil Limited, would have an effective monopoly over the supply of fuel to all domestic fuel distributors in PNG. After the competition law was enacted in 2002, the government was obliged, by its project agreement with InterOil, to make a regulation exempting InterOil's monopoly over supplying fuel to domestic distributors from the application of the competition law. This means that InterOil has an effective stranglehold over the supply, by imports or otherwise, of petrol, diesel and kerosene throughout PNG.

58. In 2006 when InterOil sought to acquire domestic fuel distributors in PNG which would give it a retail market share in excess of 60%, as well as its monopoly on supply to all distributors, the government submitted very strongly to the ICCC that InterOil's acquisition should be authorised on public benefit grounds, notwithstanding the anti-competitive effects of the acquisition. That acquisition was authorised by the ICCC, largely on the basis of the government's strong submission in favour.

59. In more recent times, the government has also granted exemption from various regulatory provisions, through amendments to several pieces of legislation, to a consortium headed by Exxon Mobil in relation to a major oil and gas exploration/production project in PNG. The exemptions include no price regulation over any products produced by the consortium (though most or all of that product would be exported anyway) and exemption from the essential pipeline access legislation which otherwise applies in PNG.

60. There is another major oil and gas exploration project under discussion in PNG involving InterOil, amongst others, and there is a probability that this project will also be granted a range of exemptions from the application of PNG law.

61. It is, of course, impossible to say whether these major oil and gas projects would have got off the ground if the exemptions they had sought had not been granted, but they do provide real life examples of the government picking national champions, albeit foreign owned, for special favourable treatment not accorded other industry participants in PNG.

9. Conclusion

62. The favourable treatment accorded these national champions may not be in the best interests of national industry policy nor in accord with best practice competition policy, however the circumstances of PNG's economic and political development have forced the government to accord that special treatment to those particular enterprises.