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6 May 2005

Mr Paul Neville MP
Chair
House of Representatives Standing Committee
on Transport and Regional Services
Parliament House
Canberra ACT 2600

Dear Mr Neville,

Inquiry into the integration of regional rail and road freight transport and their interface with ports (SCOTRS regional transport inquiry)

Thank you for the opportunity to provide a submission to the SCOTRS regional transport inquiry.

AusCID is the principal industry association representing the interests of organisations owning, operating, building, financing, maintaining and otherwise providing advisory services to private investment in Australian public infrastructure. (membership attached)

The Council was formed in 1993 and currently has 84 members drawn comprehensively from all economic infrastructure sectors, including roads, rail, ports and airports, electricity generation, transmission and distribution, gas transmission and distribution and water. As a result of its membership base, AusCID is in a unique position to articulate the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

As you will be aware, the SCOTRS regional transport inquiry is being undertaken in an environment where infrastructure issues generally, and transport specifically, are generating considerable attention through formal inquiries, regulator decisions and public debate. AusCID has contributed at length in these fora and as many of the issues are common, I attach our recent detailed submission to the ongoing inquiry into Exports and Infrastructure for your consideration. In particular, I draw your attention to the following sections:

- The real policy questions (pp 3-6)
- Roles and functions of government (pp 6-8)
- Overlapping responsibilities between tiers of government in Australia (pp 8-9)

In addition, I make the following points:

AusLink

AusCID supports the AusLink strategy and calls on all governments (Commonwealth, state/territory and local governments) to work together to reach the necessary agreements at the earliest opportunity to implement in total the measures outlined in the AusLink White Paper of June 2004.

Transport in the wider infrastructure framework

AusCID strongly believes that the greatest contribution governments can make to providing for Australia's future infrastructure needs is to develop a coherent national infrastructure strategy and to do so involves planning. Whilst AusLink and the National Water Initiative are a welcome start, still to emerge is an integrated appraisal and assessment scheme and a framework for the participation of the private sector. The key for the long term is not only a plan but to develop institutions – the lack of a high-level institutional framework based on true partnership with the private sector stakeholders is one of AusLinks greatest weaknesses.

Therefore, AusCID calls for the development of a single national infrastructure strategy that has support and commitment from all levels of government and the private sector. It is AusCID's strong view that this strategy needs to be supported by regular 'statements of investment opportunities' (focussed on market conditions and deficiencies) and identify necessary independent institutional arrangements to ensure the strategy is fully implemented and updated. The independent institutions that exist in the National Electricity Market are examples of what could be considered.

Recent studies

Lastly, I draw your attention to a significant amount of material has been released recently that addresses the general state of Australia's infrastructure, including freight transport, the benefits of improving it and the policy issues that need to be addressed. Recent major policy contributions include:

- The Australian Infrastructure Report Card sponsored by AusCID and Engineers Australia (and a number of state-based equivalents).
- Econtech's modelling of the macroeconomic costs associated with current deficiencies in Australia's infrastructure capital stock, commissioned by AusCID. (attached)
- The BCA's "Infrastructure: Action Plan for Future Prosperity".
- Infrastructure: Getting on with the job" published by CEDA in partnership with a range of infrastructure based organisations including AusCID.

In addition:

- The Queensland Government recently released "South East Queensland Infrastructure Plan and Program" (SEQIPP) incorporating transport.

And:

- The Productivity Commission, in its recent "Review of National Competition Policy Reforms" considered freight transport issues in detail in its assessment of areas offering future opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition. Regional impacts of these measures are also assessed.

AusCID feels that other organisations will be better placed to provide information on the specific policies and measures raised in the terms of reference, and as such, does not wish to comment further on any of the specific issues raised.

However, I would note that the efficiency of the transport network, both regional and urban, is likely to be greatly enhanced by national coordination, planning and independent implementation such as the strategy proposed above. A national strategy would have a direct positive impact on any specific measures that could be considered to address network impediments such as land transport access to ports.

With the Treasury forecasting a lower economic growth trajectory for Australia over the next 40 years (compared to the last 40 years), AusCID would welcome recommendations from the Committee which address the national policy, regulatory and coordination framework required to accelerate needed infrastructure investment. Such investment, based on remedying existing under-investment and on maintaining a sustainable level of ongoing investment, will impact significantly on the productivity improvements this country needs to achieve.

Yours sincerely

Dennis O'Neill
Chief Executive Officer

AusCID Submission to the Infrastructure Taskforce Inquiry into Exports and Infrastructure ….

Crisis or perpetually unfinished business?

The Australian Council for Infrastructure Development

April 2005

Executive Summary

This submission, on behalf of infrastructure investors, operators, financiers and maintenance providers, addresses the role that infrastructure plays in facilitating Australia's exports and what infrastructure policy initiatives are needed to enhance export performance.

It would be regrettable to limit the attention of this review to current infrastructure limitations in the export coal sector. Rather, AusCID urges the Taskforce to take a wider view to ensure that all Australian exporters, be they of goods or services, have access to world class infrastructure to compete in ever more challenging global markets.

The most important outcome of this review must be the development of a single national infrastructure strategy that has support and commitment from all levels of government and the private sector. It is AusCID's strong view that this strategy needs to be supported by regular 'statements of investment opportunities' (focused on market conditions and deficiencies) and identify necessary independent institutional arrangements to ensure the strategy is fully implemented and updated. The independent institutions that exist in the National Electricity Market are examples of what could be considered.

AusCID calls upon the Prime Minister to invite CoAG to consider the establishment of a National Infrastructure Advisory Council.

Beyond that, the export sector will benefit from completing the following reform agendas:

- Taxation – Imperfections in the financial relationship between the Commonwealth, states and territories impact on private investment in infrastructure provision, a significant and growing proportion of this investment activity. With telecommunications included as 'private', AusCID's 2003 survey of infrastructure investment identified some $114 billion of private investment in Australia's stock of economic and social infrastructure.

- Regulation – Policy and administration of regulation require more effective separation with better opportunity for full merit reviews. Regulatory policy needs to focus more on long-term economic efficiency, with a better balance between current prices and future investment. Regulation should not be applied where an infrastructure provider faces a small group of users in intermediate product markets. The Productivity Commission's recommendations on the National Access Regime should be implemented immediately with amendments to corresponding state legislation.

- Energy Markets – Full commitment by all state governments to the reform agenda is needed, including full retail contestability without price caps and the sale of remaining government owned energy businesses by 2010. Investor appetite is likely to remain uncertain in the absence of a national bipartisan greenhouse strategy.

- Land Transport – Early support from the states and territories for the AusLink strategy is a precondition for improved competition in the freight sector. Road and rail access pricing (including fuel excise issues) needs further development to achieve optimal modal share of the long-haul freight task.

- Water – While the National Water Initiative seeks to address many of the issues impacting on water supply and pricing, water's relevance to the efficiency of many export industries deserves noting and reinforcement by this Review.

Conclusions

Post-NCP, the infrastructure investment world has changed considerably in Australia. In a climate of growing private sector direct investment, there are policy and regulatory complexities impacting on coordinated investment in all logistic chains, not just those which operate in support of export industries. Further reforms in relation to energy and water are necessary to ensure robust and competitive supply in support of export industries.

There is an urgent need for collaborative strategies and planning by all jurisdictions in support of national outcomes, with appropriate consultative institutional arrangements to reflect the current investment framework, not that of 20 years ago.

Regulatory and taxation policy require ongoing reform to sustain timely private investment in support of globally competitive infrastructure services. At present such investment is often discouraged by perceptions of regulatory and taxation risk.

Introduction

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, maintaining and otherwise providing advisory services to private investment in Australian public infrastructure (membership attached).

The Council formed in 1993 and currently has 84 members, drawn comprehensively from all economic infrastructure sectors, including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of its membership base, AusCID is in a unique position to articulate the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

AusCID's 2003 survey of infrastructure investment identified some $114 billion of private investment in Australia's stock of economic and social infrastructure.

A significant amount of material has been released recently that addresses the general state of Australia's infrastructure, the benefits from improving it and the policy issues that need to be addressed. Beyond a growing body of scholarly work, recent major policy contributions include:

- The Australian Infrastructure Report Card sponsored by AusCID and the Institute of Engineers (and a number of state based equivalents).
- Econtech's modelling of the macroeconomic costs associated with current deficiencies in Australia's infrastructure capital stock, commissioned by AusCID.
- The BCA's "Infrastructure: Action Plan for Future Prosperity".
- "Infrastructure: Getting on with the job" published by CEDA in partnership with a range of infrastructure based organisations including AusCID.

We assume the Taskforce has access to and is familiar with this body of work and given the Taskforce's remit and relative short time frames, little is served by recounting that material. Similarly, except to illustrate important policy issues, we have avoided extensive recounting of "war stories", especially those relating to the details of individual decisions made by economic regulators.

As such the remainder of this submission is divided into two sections. The next section argues that to properly consider the issues associated with infrastructure's role in Australia's export performance, and develop policy for the future, we must look beyond the immediate public concern over specific facilities, such as Dalrymple Bay (and perhaps Queensland coal ports more generally) and Port Waratah. The final section addresses the specific questions set out in the Taskforce Issues Paper.

Seeing the forest for the trees – the real policy questions

The Productivity Commission's (PC) recent Review of National Competition Policy (NCP) presented an excellent opportunity to reflect on the success of over a decade of microeconomic policy reform and chart a future course for this important policy area which is sometimes neglected, and often misunderstood in public debate. It is important to remember, for the purpose of this review, that one of the primary objectives of NCP was to improve the performance of the tradable, and especially export, sectors through improving the productivity of the non-tradable sector.

The PC has observed that there was a range of competition based reforms which, while strictly not part of NCP, shared the same underlying rationale. A number of the basic policy elements were well in place in the early 1990s and were reinforced by the Special Premiers' Conference processes that led to reforms such as the ongoing development of uniform road transport regulation and the National Rail Corporation. Further, the process has continued with the developments in the National Electricity Market, structural separation in the rail transport industry and the injection of private equity into core energy and transport infrastructure, especially through privatisation.

Over the past few years there has been a range of inquiries conducted into areas of interest to AusCID's membership. Some of these have been conducted by the PC (such as the reviews of the Prices Surveillance Act, the National Access Regime, Price Regulation of Airport Services, the Gas Access Regime and NCP). Other important reviews at the Commonwealth level have been the CoAG review of Energy Policy (the Parer inquiry) and the subsequent Ministerial Council on energy processes, the review of the Mandatory Renewable Energy Target and the processes leading up to the recent publication of the White Paper on Land Transport (AusLink).

The outcome of these reviews, and a number of others, has been to refine and reinforce the economic aspects of infrastructure policy, in the light of changing market and institutional circumstances. Whilst AusCID believes there is still significant policy work to be done, it is our unqualified view that the quality of infrastructure service provision in Australia is much better today than it would have been if the reform program over the last decade and a half had not been pursued. Further, the quality of infrastructure outcomes at a sectoral level is strongly correlated, to the extent of targeted reform that has occurred within the sector concerned.

AusCID's views on a range of regulatory issues and our submissions to the inquiries mentioned above, and those of our members, are on the public record. As such we do not intend to revisit those arguments, although if the Taskforce wishes an update on any specific questions, we would be only too happy to answer these.

Funding and economic regulation are not the only issues that may create economic bottlenecks. Increasingly, planning and environmental issues are delaying infrastructure development. AusCID strongly supports sustainability principles and has been a leader in developing these for the infrastructure sector through its *Sustainability Framework for the Future of Australia's Infrastructure Handbook*[1]*.* However the further delay of the deepening of the shipping channel in Port Phillip Bay for environmental reasons is of concern, as are the problems being created in the renewable energy sector in relation to wind power and the ongoing uncertainty in the energy sector about greenhouse policy.

The infrastructure sector is not immune to the skills shortages faced in the Australian economy. The capacity of the construction sector to deliver infrastructure is constrained. When coupled with project management issues and the need in many cases to continue to operate infrastructure whilst it is upgraded and/or expanded, there is a real physical constraint in terms of time placed on correcting current problems and delivering future

[1] A copy is available at www.auscid.org.au/home/papers.php?id=1

demand. National strategies are needed to ameliorate these constraints if Australia is to raise its infrastructure performance to the level that delivers improved export performance.

We understand that the Prime Minister's establishment of the Taskforce and this review are motivated by a concern that infrastructure bottlenecks, such as those currently being experienced at Dalrymple Bay and Port Waratah, may be impeding Australia's export performance. However, if this review is to make a lasting contribution to maximise Australia's export performance, the Taskforce recommendations must be directed at preventing future bottlenecks rather than limited to solving current capacity constraints Further, the Taskforce needs to extend its focus beyond downstream bottlenecks that occur between the point of production and the customer, such as railways between mines and ports or port infrastructure.

Recent modelling undertaken by Econtech for AusCID shows that if Australia's rail, road, water and energy infrastructure was fit for current use, export volumes would be almost 2% higher than current levels.[2] Upstream infrastructure is of equal importance, especially as we seek to add value to resource industries or manage problems of resource scarcity. The transport of gas to aluminium smelters near Bunbury is as important to aluminium's export performance as the port infrastructure that ultimately handles the export of the aluminium. Improving water security through better infrastructure near the Murray is as important to the export performance of the horticulture and wine sectors as is dredging the channels in Port Philip Bay.

Nor should the focus be restricted to the export of goods. The Taskforce Issues Paper identifies that the export of travel services exceeds the value of coal exports by around 50%. It also exceeds the combined value of wool, wine, LNG, medicaments, copper, iron and steel and dairy products. The export of travel services is vitally dependant upon Australia's airports (an area of sole Commonwealth jurisdiction and notable policy and investment success) but also our general transport infrastructure.

Other business service exports exceed the individual value of each of the goods sectors mentioned above as well as passenger motor vehicles, nickel, aluminium and wheat. This not only further demonstrates the importance of Australia's aviation infrastructure but also the importance of our urban infrastructure in creating amenity in our cities from which high skilled knowledge based workers produce business services in an increasingly competitive global market.

There will always be tension between infrastructure providers and users and the need to ensure that infrastructure pricing policies are economically efficient. The infrastructure sector will always need to compete with other sectors for the provision of public and private sector capital and in a range of human resources markets. Major infrastructure facilities generally create impacts on groups of people that are much narrower than the groups that benefit from the infrastructure – some environmental and social impact issues are inevitable and can only be resolved within a triple bottom line approach to infrastructure strategy and planning.

Short term focused policies directed at current problems are no substitute for institutional reform and nationally co-ordinated planning arrangements. Improved co-ordination is essential if capital is to be effectively allocated. The bickering between the states and the

[2] A copy of *Modelling The Economic Effects Of Overcoming Under-Investment In Australian Infrastructure* is included with this submission.

Commonwealth about the distribution of federal spending must end. For example, it has to be acknowledged that investment in the Hume Highway north of Albury is probably as valuable for Victoria as it is for New South Wales and that improving access to the Port of Melbourne is in the national, not only Victoria's, interest. This will only ever occur if robust transparent methodologies for project appraisal and delivery timing are developed and adhered to by both the States and the Commonwealth.

To assist this process, AusCID has suggested the publication of a "Statement of Transport Opportunities" similar to that issued by NEMMCO for the national electricity market. Ideally, an annual statement of available justified projects (above a certain threshold) from all jurisdictions and across modes would be published. The discipline of this annual publication, similar in scope to the AusLink project list but more frequent and based on transparent objective criteria, could be expected to lead to a convergence in planning and project assessment processes across jurisdictions. Such a statement also has the potential to lead to the development of better market based mechanisms for investment and resource allocation from both private and government sources. Ideally, AusCID would like to see such a statement published by an independent National Infrastructure Planning Council.

The private sector has access to a vast stock of capital for investment in infrastructure. For this to flow ultimately in the most efficient way, there needs to be consistency in planning, pricing and regulation from all jurisdictions. There also needs to be a clear understanding about what types of projects are attractive to private sector investment. Of equal importance though, it needs to be understood that failure by governments to invest in those projects better suited to public provision will inhibit the efficiency of private sector investment and the industries that use both public and privately funded infrastructure.

We must not pursue reform for reform's sake. The long term costs and benefits of reform, including a rational role for regulation, must be weighed up with a view to developing institutional arrangements and policies that can and do adapt and change over time. There will always be unfinished business in infrastructure policy and the only way to avoid an infrastructure crisis, a crisis that is not yet upon us and can be avoided, is by sound long term policy solutions.

Specific Issues

In this section we address those specific questions raised in the Issues Paper.

The Taskforce will receive a wide range of submissions, undoubtedly a number from AusCID members, relating to specific infrastructure bottlenecks. Specific problems are best left to those directly involved and as such, AusCID does not propose to provide a list of bottlenecks and debate particular cases other than as illustrations of broader policy issues. However, the questions set out in the Issues Paper on pages eight and nine strike at the heart of what is required from infrastructure policy and each requires a specific response.

What roles and functions should be carried out by governments in developing infrastructure and how does this compare to the current situation?

Governments have a number of roles to play in the infrastructure sector:

- Planner (of physical assets but also of markets, such as the NEM);
- Regulator (economic, environmental, technical and safety);

- Purchaser (either for its own needs or on behalf of a part of the community); and
- Provider.

While governments perform all of these roles, in many cases they are performing them poorly.

AusCID strongly believes that the greatest contribution Governments can make to providing for Australia's future infrastructure needs is to develop a coherent national infrastructure strategy and that involves planning. Some sectors, such as electricity and airports, have institutional arrangements that seem to be working adequately, although there is clearly room for improvement. In others, and most notably surface transport (rail, road, ports and public transport) and water, co-ordinating planning arrangements are in a poor state, or non-existent. Whilst AusLink and the National Water Initiative are a welcome start, still to emerge is an integrated appraisal and assessment scheme and a framework for the participation of the private sector. The key for the long term is not only a plan but the development of institutions – the lack of an institutional framework based on partnership with private sector stakeholders is one of AusLink's greatest weaknesses.

AusCID's views on economic regulation are expressed in various places in this submission and in material we have put to other inquiries. AusCID supports the policy thrust that the PC has developed over the last few years, especially when it comes to the regulation of intermediate industrial services, that is, those provided to other businesses rather than end consumer markets. If the principles that have been developed by the PC were applied by all jurisdictions with the focus being on economic efficiency and investment rather than constraining profits and prices, many of Australia's economic regulation issues would be resolved.

There are non-economic regulatory areas that also require attention. The moves to uniform national standards and safety regulation that have been pursued in road transport and energy markets must be pursued in other sectors, especially rail.

Governments are increasingly looking to purchase services from the private sector rather than purchasing assets and providing those services themselves. This is the structural change behind public private partnerships (PPPs). While the performance of various governments in the PPP market has been mixed, governments need to become "best practice consumers" for the market to reach its true potential". In particular, a consistent national approach to tendering and contracting is needed to drive down transaction costs.

Are lagging investment decisions reflective of the transition from public to private sector ownership or simply a consequence of the nature of the infrastructure in question and the markets being serviced?

The major problem in Australia's infrastructure sector is the failure of the public sector to invest in its own core infrastructure, rather than any transitional issues associated with changes in ownership. Of the $24.8 billion deficiency AusCID has conservatively identified in Australia's capital stock today, $10 billion is in roads, $8 billion in rail and $3 billion in water. These are all sectors where the public sector is likely to remain the dominant infrastructure provider. In electricity distribution, the greatest problems seem to be in Queensland, Western Australia and to a lesser extent New South Wales where the public sector is the sole provider. These issues are nowhere as prevalent in Victoria, South Australia or the ACT, where distribution has been privatised.

The more relevant question is whether there are characteristics of infrastructure markets that result in, from time to time, supply falling short of demand and bottlenecks emerging. It is inevitable that even with the best will and policy in the world there will be sudden upward shifts in demand that cannot be met because of the timeframes taken to deliver new infrastructure capacity. There is a more general question of to what extent should infrastructure be provided in excess of current demand for future demand. The lumpiness of infrastructure means that there will be long periods where surplus capacity exists. Indeed, it may well be the case that the current infrastructure difficulties is partly a result of surplus capacity now running out.

Surplus capacity performs two roles. It provides for the future and in vertically separated industries it facilitates entry in related markets. However, it does come at a cost. In some cases, given the lumpiness of investment, today's users simply have to accept those costs or have no services at all. Where investment is less lumpy, but still takes time to deliver, there is a real tension between providing for demand (and potential competitors) and the prices paid for services today.

Is a certain level of congestion to be expected with major infrastructure from time to time given the lumpiness of that investment?

Congestion is not necessarily to be expected nor is it necessarily a function of the lumpiness of investment. Congestion is simply infrastructure demand exceeding supply at a particular point in time. It may occur for a number of reasons including:

- There as been an unexpected increase in demand and it was not possible to implement the necessary infrastructure in time to meet that demand;

- The congestion is expected to be short lived and the capacity required to meet it cannot be justified on a normal commercial basis (this is often the case with peak congestion issues at airports where the cost of the congestion is less than the cost of fixing it); and

- The demand that is causing the congestion was well understood but there were regulatory or commercial impediments placed in the way of the service provider who was otherwise prepared to provide the necessary capacity.

Broadly, it is likely that infrastructure capacity constraints will occasionally result in congestion. That is not to say that steps cannot be taken to reduce congestion. These include:

- Understanding future demand patterns (such as the work being done on the freight task);

- Planning for future demand, especially in relation to developing sustainable land use policies and prompt planning decisions and through smart infrastructure design, especially that directed at reducing investment lumpiness; and

- Ensuring that regulatory policy does not lead to sub-optimal capital design or gaming by incumbents seeking to prevent entry.

Are overlapping responsibilities between the three tiers of government in Australia leading to unnecessary delays or costs?

From an investor's perspective, the existence of multiple layers of government are causing a number of problems. The first is the dominant theme of this submission – the need for co-ordinated national infrastructure planning. This problem can be solved once the states and Commonwealth can put aside differences and work together in the national interest.

The second is in taxation policy. As the private sector has sought to work with the states, where primary infrastructure delivery responsibility largely rests, it appears that the Commonwealth views the private sector's use of tax deductions as a form of jurisdiction cost shifting, much in the way the states in the past used leases to circumvent Loans Council borrowing restrictions. Tax policy has worked to frustrate private sector investment (by adding cost and delay), not to encourage it, or even remain neutral.

If the administration of the tax law contradicts other areas of government policy, the result is increased investor uncertainty on the overall stance of government policy. To ensure this is not the case in the infrastructure sector, it is important that:

- While the tax system ideally should remain neutral to most forms of investment, in certain cases it discriminates against some types of lumpy infrastructure investment. For these, the tax system should create incentives to improve investment efficiency. and increase competition in other markets. It appears that the current approach proposed for Division 250 (to deal with s51AD and D16D issues) may, for example, deter investment in road and other infrastructure capable of funding by shadow payments; and

- The tax system should not cause distortions in contestable markets where both government and privately owned firms operate. It seems likely, based on the current exposure draft, the proposed amendments to Division 250 will impact on the National Electricity Market by creating a distinction between energy sold to state government owned retailers and privately owned retailers.

The third is in relation to environment policy. Energy and transport (and potentially water if desalination becomes widespread) are significant producers of greenhouse emissions, as are the producers of basic materials used in infrastructure construction: concrete, steel and bitumen for example. Significant investment requires certainty that future outcomes will be globally acceptable. Whilst AusCID welcomes the attempts of the State Governments to reach an agreement on emissions trading, the robustness of such a national arrangement depends on the ongoing commitment by every State. This is a global issue that has the potential to impact on Australia's trade directly, as well as the development of our national infrastructure systems. It is therefore worth a significant policy effort from the Commonwealth Government.

Where infrastructure assets remain in government control, to what extent are competing government policies and objectives impeding pricing and investment decisions in relevant infrastructure?

As discussed above, AusCID analysis suggests those sectors where the capital stock is most deficient are those where governments remain the dominant suppliers. The pursuit of budget surpluses and debt reduction as the primary goal of fiscal policy at both state and federal level, by governments of all political persuasions, is a key cause of these problems. Whilst increasing private sector involvement and privatisation has to some extent ameliorated the impact of this regressive policy stance, the long term economic consequences are now evident. The solution to this problem though is simply not only increasing expenditure but also developing frameworks that enable private and public capital to invest efficiently.

It is not just misguided fiscal policies that impact on infrastructure efficiency. In a recent survey of market participants by PricewaterhouseCoopers[3], 57% of respondents believed

[3] PricewaterhouseCoopers (2004) *Supply Essentials: Utilities global survey 2004*, accessed on 9 June 2004 at http://www.pwc.com.

that to deliver a truly efficient national energy market, full retail contestability needs to be adopted within all jurisdictions within 1-2 years. The remainder of respondents said this was essential with 2-3 years. It is the expectations of respondents that are most concerning – 58% believe the necessary reforms will take between 5 to 10 years and 14% believe they will never occur.

Full commitment to the energy market reform agenda by the relevant state governments is critical to ensuring Australian exporters have access to efficient energy supply. Further, it is AusCID's view that the Commonwealth take immediate steps to ensure:

- full retail contestability in all jurisdictions;
- market conduct and treatment of participants regardless of government or private ownership; and
- energy businesses currently owned by state governments are sold by 2010.

How significant a factor is regulatory risk in relation to investment decisions?

Regulatory risk takes two forms – decision making by regulators and regulatory policy making. The most commonly understood is that which arises from the decision making activities of regulators and the impact that those decisions have on prices. These are not just issues about allowable returns but uncertainty about methodology and what expenditures will be allowed into operating and capital cost bases. The extent of this risk depends on a range of factors including which regulator is involved, how mature the framework is, the nature of the financial exposure that regulatory decisions create and the ability of individual firms to manage this risk.

The response to this type of risk is usually to delay capital commitment until such time as these issues are clear, if that it is at all possible. The delay that has been experienced in increasing capacity in the Dampier-Bunbury Gas Pipeline is directly a result of the uncertainty created by the decision making of the Western Australia Gas Regulator that also ultimately led to the break-up of Epic Energy. In a similar vein, the administration of the airport price control regime by the ACCC became so unpredictable that the Board of Melbourne Airport refused to undertake any aviation related investment until it had a final pricing decision from the regulator.

Regulatory risk also arises from regulatory policy making. That is, the policy decisions that government and others make about what infrastructure and in broad terms how. Whilst there is has been a general policy trend to wind back regulation, which AusCID welcomes, many infrastructure owners are subject to Part IIIA of the Trade Practices Act. This enables the Australian Competition Tribunal to impose compulsory arbitration by the ACCC on an infrastructure provider, even though that provider may have been complying fully with other tenets of government policy. The risk of the imposition of regulation, either by government policy or judicial decision making means that investments undertaken today in good faith are subject to significant value loss in the future. While the idea of access holidays will assist in protecting greenfield investors, those undertaking major upgrades on existing assets may not receive the same level of protection. How this might affect investment behaviour is unclear and probably will remain so until regulation is re-imposed on a non-regulated business and that business is exposed to adverse arbitration.

Do vertically integrated supply chains have superior features to those where the operation of the different components of the logistics chain are independently owned?

This question can only be meaningfully addressed on a case by case basis and revolves around the nature of competition in the final product markets and the extent to which access to essential infrastructure is necessary to enter the market. This is best illustrated by some examples:

- It is clearly undesirable for airlines to control airports – a fact clearly recognised in Commonwealth legislation. Australian domestic airlines clearly frustrated Compass Marks I and II through their control of domestic terminal infrastructure. The entry of Impulse and Virgin Blue was only possible because Sydney and Melbourne Airports built new facilities and even then the incumbent carriers used planning and regulatory processes to frustrate that entry;

- Rail track is less clear. It seems highly desirable that the major trunk network, where above rail competition is possible, be vertically separated. However, the case is much less clear in those situations where the railway is built by a firm for its own private use (such as in the Pilbara) or where the railway has relative few uses and serves quite specific markets (such as Pacific National's network in Victoria); and

- Similarly, it is not clear that the collective ownership by users of facilities such as the coal loader at Dalrymple Bay is desirable. AusCID's understanding is that the operators of Dalrymple Bay consult regularly with the user group which did not alert the terminal operators in a timely way to the likely surge in demand. Further, the collective ownership of such facilities would raise legitimate competition concerns, especially about the preparedness of incumbents to invest through a joint venture to facilitate new entrants.

Do regulatory arrangements balance the competing needs of infrastructure users and providers, enabling adequate investment in infrastructure, or are they distorting decision making and investment decisions?

It is AusCID's long held view that regulators have been primarily motivated by removing rents from regulated firms and to a lesser extent looking after the (short run) interests of users and consumers. In many cases the regulatory regimes they have been asked to administer have been vague and possessed conflicting objectives.

The outcome of this approach is ultimately to present infrastructure operators with a set of prices w below what is needed to cover their long run costs. In the short run, given that such a large proportion of costs are sunk, there is little damage done but in the long run, investment is not forthcoming leading to socially sub-optimal levels of supply. In many cases this leads to reduced competition in related markets as incumbents hoard access to essential infrastructure. Also, by holding down prices, regulators run the risk of stifling innovation and skewing investment to less risky projects.

The focus of regulatory policy must be long run economic efficiency in the allocative, productive and dynamic efficiency sense. Distribution should not generally be the focus of regulatory policy and in particular, holding down prices for their own sake should not be an objective of regulatory policy.

Furthermore, AusCID considers that there has been a tendency by some regulators to pursue the notion of a 'correct' pricing outcome in a given situation. This may result from an overly academic and mechanistic approach to the detail of cost of capital calculations, rates of return and risk factors. AusCID subscribes to the view put by the PC in 2001 that it would be better to err slightly on the high side for pricing outcomes and thus keep investment flowing. Any pricing result which stifles investment is clearly a 'wrong' result despite the best efforts in relation to the mechanistic inputs to pricing models.

In short, the principal question to answer is whether to regulate or not. The secondary question then involves what type of regulation. In either case, AusCID argues that 'less is more' and that fewer, clearer regulatory criteria are superior to more intrusion and, effectively, micro-management in an area where regulators do not have commercial expertise.

Is there a problem with regards to the timeliness of regulatory decision making? Can decision times and processes be improved? If so, how?

Major regulatory decisions are rarely completed within six months and if an appeal process is involved, the minimum time frame appears to be one year. They are necessarily inferior to commercial negotiations because of the need to demonstrate due process and transparency through the publication of issues papers, draft decisions and final decisions.

Regulators are usually concerned for the precedents they may be setting for the regulation of the firm concerned, the industry in question and sometimes totally unrelated industries. Whereas commercial negotiating parties can focus on the issues of strategic issues for them, regulators feel obliged to scrutinise all operating and capital cost elements, often commissioning independent experts to inquire into all operational aspects of the firm's business.

This sort of conduct is probably inevitable. Processes could be hastened by providing better qualified resources to regulators and narrowing the range of matters they are required to consider. The best way to speed up regulatory decision making is to construct policies that reduce the number of regulatory decisions that actually need making.

Are regulatory regimes impeding the development of commercially negotiated outcomes that could lead to investment levels closer to the optimum?

When the Commonwealth privatised the Federal Airports Corporation its stated policy was "*over time, the Government wants to see airport operators negotiate directly on pricing and investment*"[4]. When the PC reviewed airport price controls in 2002 it found

> *The notion of promoting commercial agreements has immediate appeal because they could circumvent the need for high level regulatory involvement. However the Commission considers that any such arrangements, to be successful necessarily must be negotiated voluntarily (by both sides), without automatic recourse to the regulator and without prescriptive requirements.*[5]

During the period that effective price controls were imposed on airports, no commercial agreements were put in place between airports and airlines for general airport services. After the Commonwealth announced the abolition of price controls in favour of a monitoring regime in May 2002, by mid July that year Melbourne Airport announced five year commercial agreements with airlines for airport services, including capital expenditure of $150 million (now worth $220 million), mainly related to providing infrastructure for the Airbus A380. It has been reported by those involved on both sides of these negotiations

[4] Press release issues by the Treasurer the Hon Peter Costello, 25 June 1997.

[5] Productivity Commission (2002) *Price Regulation of Airport Services*, Inquiry Report No. 19, January, pxxxiv.

that the agreements reached, which have been acknowledged by airlines as best practice, would not have been achieved by a regulator.

If negotiations occur in an environment that the user can turn to a regulator to set some or all of the access terms and conditions (as there is under Part IIIA of the TPA and the Gas Code), then there is very little incentive for that user to reach a conclusive agreement. Put simply, given the general conduct of regulators, users will believe that the point at which negotiations break down, the supplier's final offer, is the worst outcome that they will achieve. Given that the costs of proceeding down the regulatory path are then small relative to the potential gains large (and potential losses virtually non-existent), why would users possibly agree?

The PC makes exactly this point in its review of the Gas Code but then goes on to explain the economic consequences:

> *The outcome has been that third party access is essentially based on the regulator approved cost-based reference tariffs. There is a high degree of risk that the price set by the regulator is no more efficient than that which would have prevailed in the absence of price regulation, particularly given the other deficiencies in the regulation discussed below. There is a prospect that the regulation of prices is leading to a distortion in investment (towards lower risk projects) and delaying the development of new pipelines, which then slows down the emergence of competition in related energy markets and between pipelines*[6].

The PC has put forward a range of recommendations that would improve the functioning of the national access regime. *We would urge the Taskforce to recommend to the Prime Minister that these be enacted as soon as possible and the Commonwealth work with the States to ensure similar state legislation achieves the same level of regulatory best practice.*

Is resort to arbitration, merits and judicial review simply a reflection of the system working or are stakeholders gaming the regulatory framework to maximise private benefits?

We have outlined the systematic problems that exist where a regulatory option is over-laid on commercial negotiation frameworks.

AusCID has long held the view that full merits review is an essential feature of any regulatory system that is going to enable regulators to determine commercially significant outcomes. Access to these reviews should be quick and relatively cheap and the performance of the regulatory system, and the regulators in particular, should be judged not on how many merit reviews are undertaken but how few. AusCID has in the past suggested the Australian Competition Tribunal would be an appropriate body. However for it to provide effective and timely outcomes it would need to be better resourced and probably move away to some degree from its current judicial *modus operandi*.

Where there have been issues associated with regulators' decisions and full merit reviews have not available regulated business have been able to get redress in the Courts. AusCID understands that some regulators have suggested this is an indication that the current regimes are well functioning. The overwhelming majority of these judicial reviews (the majority of which have been in energy sectors and which often have been merit reviews in disguise) have been resolved in favour of the regulated businesses. That

[6] Productivity Commission (2004) *Review of the Gas Access Regime*, Inquiry Report No. 31, 11 June, p. xxviii.

regulators are regularly having their decisions over turned or modified in the courts indicates only one form of gaming: that of an institutional nature by the regulators themselves. Understandably, these judicial processes require substantial financial and time commitments on the part of business to bring actions against organisations that have relatively unlimited resources and in some cases, even if proved wrong, can pass their costs back to the regulated business. This only leads ultimately to higher costs and delayed infrastructure outcomes.

Conclusions

Post-NCP, the infrastructure investment world has changed considerably in Australia. In a climate of growing private sector direct investment, there are policy and regulatory complexities impacting on coordinated investment in all logistic chains, not just those which operate in support of export industries. Further reforms in relation to energy and water are necessary to ensure robust and competitive supply in support of export industries.

There is an urgent need for collaborative strategies and planning by all jurisdictions in support of national outcomes, with appropriate consultative institutional arrangements to reflect the current investment framework, not that of 20 years ago.

Regulatory and taxation policy require ongoing reform to sustain timely private investment in support of globally competitive infrastructure services. At present such investment is often discouraged by perceptions of regulatory and taxation risk.