# Submission to the Senate Economics Legislation Committee Inquiry into the *Trade Practices Amendment (National Access Regime) Bill 2005*


**The Australian Council for Infrastructure Development**

July 2005

## Executive Summary

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure. Attached is a current list of the Council's members.

The reforms contained in this Bill are an important part of the ongoing renovation of Australia's infrastructure policy that was started even before Part IIIA was inserted into the *Trade Practices Act 1974* (the Act) in 1995. If the Australian economy is to continue to grow at world leading rates to provide the level of prosperity and services the community expects, then AusCID considers infrastructure policy will be "perpetually unfinished business", requiring constant review and updating in the face of changing domestic and global circumstances.

AusCID and its members have been active participants in the various inquiries that the Productivity Commission (PC) has conducted in relation to infrastructure regulation over the past few years. AusCID's submissions to the PC's inquiry that ultimately led to this Bill are available on the PC's website. We strongly support the PC's policy thinking on these matters and note it is consistent with the recent recommendations to the Prime Minister by the Exports and Infrastructure Taskforce.

The focus of regulatory policy must be delivery of 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 the perceived short run benefit of end users should not be an objective of regulatory policy.

AusCID believes that the measures contained in the Bill not only improve the operation of Part IIIA but also will over time give investors who may be exposed to its application greater certainty about outcomes.

AusCID would urge the Committee to recommend the Senate adopt the provisions contained within the Bill with one exception. That exception is the Bill be amended to replace the determination of pricing principles by the Minister contained in Division 6A, with the statutory principles accepted by the Government in its response to the Review of National Access Regime undertaken by the Productivity Commission.

AusCID also urges the Committee to recommend the Government bring forward further amendments to include price monitoring with the National Access Regime either in this Bill or as a separate bill as a matter of urgency.

## Introduction

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.[1] The Council formed in 1993 and currently has 76 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 consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

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We strongly support the PC's policy thinking on these matters and note it is consistent with the recent recommendations to the Prime Minister by the Exports and Infrastructure Taskforce.

As such, the Bill that implements the vast majority of the PC's recommendations flowing from the review of the National Access Regime has AusCID's strong support and that of the vast majority of investors in, and service providers to, Australia's infrastructure sector. That said, it is disappointing that so much time has passed since Government's response to the PC's report on 20 February 2004 and the introduction of this Bill.

The reforms contained in this Bill are an important part of the ongoing renovation of Australia's infrastructure policy that was started even before Part IIIA was inserted into the *Trade Practices Act 1974* (the Act) in 1995. If the Australian economy is to continue to grow at world leading rates to provide the level of prosperity and services the community expects, then AusCID considers infrastructure policy will be "perpetually unfinished business", requiring constant review and updating in the face of changing domestic and global circumstances. Meeting this challenge is a responsibility of all levels of Government and we applaud the Council of Australian Governments (CoAG), on this occasion led by the Premier of Victoria, for giving these issues appropriate prominence in the national economic debate.

It is useful to consider briefly the current state of play in infrastructure policy in Australia – this constitutes the first part of this submission. The second part provides some more detail on policy problems Part IIIA seeks to address and the final section addresses specific issues raised by the Bill.

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[1] Attached is a current list of the Council's members.

[2] Submission numbers 11, 80 and 117 at http://www.pc.gov.au/inquiry/access/subs/sublist.html

## Seeing the forest for the trees – the real policy issues.

The PC's recent review of National Competition Policy was an excellent opportunity to reflect on the success of more than a decade of microeconomic policy reform and to chart a future course for this important policy area which is sometimes neglected and often misunderstood in public debate.

The PC 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 with the Special Premiers' Conference processes that led to reforms such as the development of uniform road transport regulation, rail standardisation and the establishment of 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 National Competition Policy). 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, the processes leading up to the recent publication of the White Paper on Land Transport (Auslink), and the recent inquiry into export infrastructure undertaken by the Exports and Infrastructure Taskforce.

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

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 its 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 half had not been pursued. Further, the quality of infrastructure outcomes at a sectoral level is strongly correlated to the extent of reform that has occurred within the sector concerned.

The Prime Minister's establishment of the Exports and Infrastructure Taskforce was 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 policy is to make a lasting contribution to maximising Australia's export performance it must be directed to ensuring that bottlenecks do not occur in the future, rather than solving issues associated with problems that are manifest today.

Further, the policy focus must not be restricted to downstream bottlenecks – those that occur between the point of production and the customer, such as railways between mines and ports or port infrastructure or seaports themselves – the focus of Part IIIA. Recent modelling undertaken by Econtech for AusCID shows that if Australia's rail, road, water and energy infrastructure was fit for purpose then the level of exports would be almost 2% higher and GDP nearly 1% more than today.[3] 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 refineries near Bunbury is as important to aluminium 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 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[4]. 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 its general transport infrastructure.

Other business services 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 its urban infrastructure in creating amenity in its 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 – environment impact issues are inevitable.

The private sector has access to a vast stock of capital to invest in infrastructure. For this to ultimately flow in the most efficient way there must a commonality of purpose and approach from all jurisdictions in relation to planning, pricing and regulation. There also needs to be a clear understanding about what sorts 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 which are better suited to public investment will inhibit the efficiency of private sector investment and the industries that use both public and privately funded infrastructure.

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[3] A copy of that research is provided with this submission for the Committee's information.

[4] *Australia's Export Infrastructure*, Report to the Prime Minister by the Export and Infrastructure Taskforce, Canberra, May 2005, p9.

We must not pursue reform for reform's sake. The long term costs and benefits of reform 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 approaches.

## Economic issues associated with Part IIIA.

The conduct of the Queensland Competition Authority (QCA) in relation to the Dalrymple Bay coal terminal has brought the conduct of regulators and the potential of their conduct, into the public domain. There are a range of issues in relation to this matter that are not well understood and rather than canvass them in this submission, a copy of AusCID's submission to the QCA is attached for the information of the Committee. However, the most important lessons to be drawn from this case are not to be found in the relative merits of the conduct of state and federal regulators – there are a number of examples of federal regulatory agencies taking similarly unacceptable time periods to reach decisions. Rather, the important lessons are to be found in answering the fundamental questions of when to regulate and how.

AusCID's basic regulatory proposition is that regulation should only be applied where there are strong grounds to believe that, left unregulated, the firm in question will act in a way that damages economic efficiency. In other words, regulation must have an efficiency rather than distributional focus, especially in those cases where intermediate industrial services are involved.

When regulation is applied, it should be done so with great care with an emphasis on ensuring that commercial conduct in the relevant markets is as normal as possible and that regulatory decision making should not lead to perverse behaviour, especially in relation to investment. It must be predictable, transparent and accountable.

Part IIIA relates primarily to the situation of a business seeking to utilise the services of a facility (that is uneconomic to duplicate) owned by a competitor but cannot gain access on terms and conditions that would enable it to compete. Part IIIA does not seek to address issues associated with services provided to end consumers, such as electricity or gas distribution, or residential water and telecommunications supply. The interests of consumers are to be found in the requirement that where Part IIIA is applied, competition must be enhanced in a market other than the market for the service in question.

The classic access problem is where a firm seeks access to facilities of one of its competitors – this is best seen in the railway industry and telecommunications[5] although recently there has been an application of this type in relation to sewerage services in Sydney. Typically, the incumbent operates a vertically integrated business and a competitor seeks access to infrastructure (such as a railway line or

[5] Although telecommunications access is dealt with specifically under Part XIC of the Act, the economic problem is the same.

the copper local loop) which is uneconomic to duplicate in order to provide services, in competition with the infrastructure owner, to end consumers or businesses. The incentive to deny or frustrate access (either through terms and conditions or charging excessive prices) is provided through a desire on the part of the infrastructure owner to maximise its competitive position in the markets in which it competes with the access seeker.

However, Part IIIA is not limited to this situation and can be applied to services provided to firms that are not competitors of the infrastructure owner if the relevant tests in the Act can be met. The application to declare domestic airfield services at Sydney Airport current before the Australian Competition Tribunal (the Tribunal) is an example of this. The recently resolved dispute at Dalrymple Bay is another example of this policy problem although it was not a matter within the scope of Part IIIA, being subject to Queensland access regulation.

Here, the problem is that of a monopoly charging above efficient prices. However, disputes of this type are often about the distribution of rent between the supplier of the infrastructure and the access seeker and within a broad range of pricing outcomes, there is no material impact on consumers – the Sydney Airport matter is an example of this.

The arbitration provisions of Part IIIA present the same danger that excessively heavy price controls generally do – that prices will be set too low to bring forward investment. The most extreme example of this form of regulatory failure was in setting of prices for the Dampier to Bunbury gas pipeline which significantly delayed its expansion and ultimately led to the failure of Epic Energy. Similar concerns in part motivated the PC to recommend to the Government the replacement of airport price controls by a monitoring regime.

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 perceived (short run) interests of users and consumers. In many cases, they have been aided by the regulatory regimes they have been asked to administer being vague and having conflicting objectives.

The outcome of this approach is ultimately to present infrastructure operators with a set of prices which are below those needed for them 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 also leads to diminution of 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 timeframes considered when making major infrastructure investments are best measured in decades. As a result, certainty about the regulatory treatment of investment not just today but in five, ten or twenty years is of critical importance. Thus, investment outcomes can be expected to enhance if investors are confident that regulatory frameworks are robust, transparent and predicable. This is particularly important for Part IIIA as it can be applied to facility at any time subject to the relevant tests in the Act being met.

The focus of regulatory policy must be delivery of 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 the perceived short run benefit of end users should not be an objective of regulatory policy.

AusCID believes that the measures contained in the Bill not only improve the operation of Part IIIA but also will over time give investors, who may be exposed to its application, greater certainty about outcomes.

## Specific Provisions of the Bill

The Bill contains a range of measures. A large number of the measures go to increasing the transparency of decision making, providing time lines for decision makers and increasing accountability through the publication of reasons and reporting on specific decisions and the operation of the regime in general. These reforms, along with others contained in the Bill, are most welcome.

There are some matters contained in the Bill that AusCID believes require further discussion.

### *Objects clause*

AusCID has long advocated the insertion of an object clause for Part IIIA. In a number of regimes (such as the old airports regime or the gas code), the objectives are unclear, unstated or lack internal consistency. The Bill contains amendments requiring all decision makers to have primary regard to economic efficiency rather than more woolly notions such as industry development or protecting users and seek to encourage a consistent approach.

AusCID would encourage all Australian Governments to include this objects clause in the various general and industry specific regimes they administer. Consideration of this issue should be part of the current CoAG infrastructure agenda.

### *Pricing principles*

Certainty about pricing outcomes is the most important issue in the regime with perhaps the exception of the declaration criteria. The absence of clear, appropriate and enforceable pricing principles has been at the core of the tension between infrastructure providers and regulators. These tensions have led to significant legal action including cases brought by Epic Energy against both the ACCC and the WA gas regulator and GasNet's action against the ACCC. Specific details of these cases can be provided to the Commission if desired.

In its response to the PC report the Government set out the following pricing principles :

> *'The Australian Competition and Consumer Commission (ACCC) must have regard to the following principles:*
>
> *(a) that regulated access prices should:*
>
> *(i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and*
>
> *(ii) include a return on investment commensurate with the regulatory and commercial risks involved.*
>
> *(b) that the access price structures should:*
>
> *(i) allow multi-part pricing and price discrimination when it aids efficiency; and*
>
> *(ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.*
>
> *(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.'*

These principles will enhance the certainty, transparency and accountability of regulatory processes for access pricing.

Perhaps the most important element of the Government's response to the PC report was that these pricing principles would be included in legislation amending Part IIIA. However, the Bill does not include pricing principles per se, but proposes a new Division 6A that requires the Commonwealth Minister, by legislative instrument, to determine pricing principles. This is both surprising and concerning as the Government agreed to a set of pricing principles after consulting with the States and Territories. Neither the Second Reading Speech nor the Explanatory Memorandum explains why the Government has changed its position.

In the absence of such an explanation this raises concerns that the pricing principles to be introduced by legislative instrument will not be those outlined by the Government in its response to the Productivity Commission. AusCID strongly supports the pricing principles as proposed by the PC and previously accepted by the Government. Any attempt to alter them without explanation and thorough consultation (such as that undertaken by the PC) would run contrary to encouraging a climate of certainty for infrastructure investment. The need to do so may also be questioned as the PC's inquiry into the National Access Regime was thorough, was effectively endorsed by all Australian Governments and it has since confirmed the appropriateness of the Government's pricing principles in its review of the Gas Access Regime.

The use of a legislative instrument to establish the pricing principles raises significant concerns for infrastructure investors about the potential of future Governments to alter the principles in response to short run pressures. This concern would be significantly reduced if the pricing principles were incorporated into the Bill. This would require the current Bill to be amended.

Whilst there may be a theoretical trade-off between the certainty of including the principles in legislation and the flexibility of including the principles in regulation, it does not justify the exclusion of pricing principles from the primary legislation. It is critical is that infrastructure investors know with certainty that regulators dealing with pricing issues are obliged to comply with well defined pricing principles. In relation to investment in infrastructure the need for certainty outweighs the benefit of flexibility. Certainty is best achieved via the incorporation of the pricing principles in the Bill currently being considered by the Committee.

In the event that the current Bill is not amended to include the pricing principles AusCID would continue to urge the Government to implement the pricing principles as per the Government's response to the PC report and only change these after thorough consultation with relevant stakeholders.

AusCID recognises the PC did not recommend inclusion of monitoring in its review of the National Access Regime. However given PC's subsequent work on the Gas Code and monitoring being at the heart of the Commonwealth's approach to airport regulation, we are disappointed that the Government has not sought at this time to include this as an alternative to declaration. The report to the Prime Minister of the Exports and Infrastructure Taskforce supported monitoring as a regulatory option. We would urge the Government to consider whether appropriate amendments to provide for price monitoring within the general access framework could be brought forward by the Government whilst the Bill in before the Parliament.

Monitoring is used by Victoria and South Australia for the regulation of ports and by the Commonwealth for the regulation of airports. The ongoing viability of the airports regime, and potentially the state based regimes, may be called into question by the outcome of the application to declare certain services at Sydney Airport currently before the Tribunal. There is a risk that infrastructure providers fully compliant with those regimes may be subject to the application of Part IIIA – such regulatory double jeopardy must be avoided. Inclusion of formal monitoring within Part IIIA or recognition of monitoring regimes as effective access regimes, would provide certainty for such firms. At least in relation to Commonwealth regimes, this could be done by deeming monitoring (and indeed prices notification) under Part VIIA of the Act to be an effective regime for the purposes of Part IIIA.

### *Promotion of competition test*

As discussed above, the primary purpose of Part IIIA is to deliver benefits to consumers through the promotion of competition in upstream markets rather than simply act to restrict the use of market power in the market for the service concerned. The amendments to the promote competition test will ensure that tangible competition benefits will need to be demonstrated rather than the current situation where trivial improvements in competition are sufficient to meet this criteria.