Australian Competition & Consumer Commission

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Ed Willett, Commissioner

In May this year two reports prepared for two very different governments, one a state Labor government and the other a Commonwealth coalition government both reached the same conclusion – there is no infrastructure crisis in Australia.

"There is no infrastructure crisis in Australia" was in fact the very first sentence of the Victorian report, and it went on to say that *"The quality of the nation's infrastructure has helped underpin Australia's strong economic performance over the last decade and provides us with an advantage in competing for footloose investment projects in the region."*[1]

This would not have come as any surprise to international observers after the most recent OECD economic survey of Australia singled out National Competition Policy reforms as playing a central role in Australia's economic success story and declared that in "the last decade of the 20th century Australia became a model for other OECD countries".

What the OECD was saying was that the ACCC regulated opening up of the nation's state controlled infrastructure has, far from retarding our growth, actually lifted our GDP beyond its long term growth path.

Our own Productivity Commission estimates this at around 2.5 per cent of GDP.

This is starkly at odds with some of the doom and gloom we have heard surrounding the infrastructure debate in recent months. I therefore want to highlight a few key areas, namely energy and telecommunications, so we can distinguish the facts from the unsubstantiated assertions, and in the process highlight what are the real issues in infrastructure regulation, and what can be done to improve them.

Energy infrastructure investment

Some of the more alarming claims about the infrastructure crisis have come in the energy sector.

For example, in a media release on 28 October 2001, the Australian Pipeline Industry Association stated that:

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[1] *"Investing in Australia's economic infrastructure"* Report to the government of Victoria prepared by the Allen consulting group, May 2005. Page 4

> *The current regulatory quagmire is suffocating new pipeline development and requires urgent policy attention by governments.*[2]

Yet, according to the Pipeline Industry Association's own figures, 14,000 km in new transmission pipelines have been laid in Australia since 1997. This amounts to a doubling in the length of transmission pipelines to 28,000 km in just seven years.

Capital expenditure on new pipelines has increased substantially with major new pipelines to have been constructed recent years including:

- Eastern Gas Pipeline: Longford (Vic) to Sydney
- Tasmanian Gas Pipeline: Longford (Vic) to Tasmania
- Roma to Brisbane Pipeline looping
- SEA Gas Pipeline: Port Campbell (Vic) to Adelaide
- North Queensland Gas Pipeline: Moranbah to Townsville
- Telfer Gas Pipeline: Port Hedland to Telfer (WA)

In addition, two new pipelines currently under advanced stages of planning and development are.

- Central Ranges Pipeline: Dubbo to Tamworth
- PNG Gas Pipeline: Papua New Guinea to South East Queensland (including a lateral to Gove in the Northern Territory)

The proposed PNG pipeline, with expected capacity of around 200PJ a year, will be one of the largest pipelines that Australia has seen in recent times. On completion, it may even satisfy most of the additional demand for gas and probably result in no new major pipeline developments to service the eastern Australian gas markets, for some considerable time.

Since responsibility for transmission regulation in the National Electricity Market began being progressively transferred to the ACCC in 1999, our decisions have accommodated over $4.5 billion in transmission investment.

Just this year the ACCC paved the way for $1.4 billion in new investment in electricity transmission in NSW and the ACT alone over the next five years with its final revenue cap decisions for TransGrid and EnergyAustralia.

It was no surprise therefore that in response to the 2002 Parer Review, the Ministerial Council on Energy agreed that significant benefits had arisen as a result of the opening up of energy markets including:

- Considerable integration of the wholesale electricity markets in Victoria, New South Wales, Queensland, the ACT and South Australia.
- Substantial investment in new electricity generation and gas production, and in particular in electricity and gas transmission interconnection between states in eastern and south eastern Australia.

[2] Australian Pipeline Industry Association 28 October 2001, *Media release: urgent call for national leadership in Australia's gas infrastructure development*.

- Vigorous electricity retail competition in the medium and large business sector and accelerating competition in the newly opened household and small business markets in NSW and Victoria.
- High levels of supply security, and improvements in network reliability.

So how does one square results like these with the more pessimistic view coming particularly from certain sectors of business? For example, according to CEDA:

> *"There is a serious backlog in infrastructure investment, in water, energy and land transport, estimated conservatively at $25 billion, which requires immediate attention. Institutional structures – those of Commonwealth, State and Local governments – which have served Australia well in decades past now appear unable, and ill-equipped, to grapple with the nation's present infrastructure planning and delivery challenge."*[3]

Or this, from the Business Council of Australia report from March

> *"the current state of Australia's most fundamental infrastructure – supporting all elements of the transport network, energy and water supplies, and the basic facilities to support growing and spreading urban communities – is in urgent need of reform, repair and expansion. We are at the crossroads in terms of infrastructure development as a result of poor institutional arrangements and policy choices."*[4]

While there appears to be a divergence of views it is possible to reconcile, at least in part, the views expressed in these latter reports as saying that however well we have done in the past we need to do better if we are to be able to meet Australian infrastructure needs.

Streamlining and improving regulation

In other words, the question is not "is there an infrastructure crisis due to over zealous regulation" – as both the Victorian and Commonwealth government reports have found, the answer is clearly no.

Rather, the question should be: are there regulatory arrangements and practices in certain sectors which can be improved to promote investment in essential national infrastructure in the long term interest of the nation? The answer clearly is yes.

The Prime Minister's Economic Infrastructure Taskforce concluded:

> *The greatest impediment to the development of infrastructure necessary for Australia to realise its export potential is the way in which the current economic regulatory framework is structured and administered. It is adversarial, cumbersome, complicated, time consuming, inefficient and subject to gaming by participants. There are*

[3] "*Infrastructure: Getting on with the Job".* Committee for Economic Development of Australia April 2005. Page 5,
[4] *"Infrastructure action plan for future prosperity"* Business Council of Australia March 2003 Page 3

too many regulators and regulatory issues are slowing down investment in infrastructure used by export industries.[5]

This is where, in the opinion of the ACCC, we get to the nub of the problem.

Everyone wants quick decisions by regulators, but not everyone is happy to accept the umpire's verdict, and thus many projects get mired in judicial challenge, appeals, court verdicts and tribunals.

Even the threat of judicial challenge, seldom far below the surface in these matters and regularly above it, is enough to slow decision making as regulators become overly cautious in the face of threats of litigation.

Take Sydney Airport for example, and the process still underway to decide whether or not to declare airside services.

That first began with application to the National Competition Council in August 2002, there was draft report in June 2003 and final report in November, a ruling by the minister in January 2004, and then the whole thing goes on review to the Competition Tribunal and we still don't have a ruling on that.

Assuming the Tribunal does declare the airport, there is then a negotiating process which could take six months to a year, and if there's no agreement the ACCC arbitrates, and anyone unhappy with our ruling can have that reviewed by the Tribunal. Oh, and every one of these steps is open to appeal in the Federal Court.

By my count it will be six or seven years to complete this process, by which time, say, Boeing has announced plans to design some new aircraft to compete with the new Airbus A380 and the whole process has to start again.

And this is not an isolated incident. In the Pilbara there is still no clear ruling on whether rail track services are covered by the Trade Practices Act and whether rival miners can have access to the services, eight years after the issue first arose.

In addition to the adversarial, cumbersome, complicated, time consuming and inefficient process, there is the plethora of regulators.

In the ACCC's submission to the taskforce, we pointed out that while the competition policy reforms of the mid 1990s were intended to establish a national approach to competition issues across jurisdictions and markets, the reality is there has been a proliferation of different access regimes at the State and Territory level.

There are currently 22 State-based regimes in operation covering rail, ports, gas and electricity and 11 Federal, State and Territory economic regulators:

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[5] *Australia's Export Infrastructure"* report to the Prime Minister by Australia's Export Infrastructure Taskforce. Page 2

- Australian Competition and Consumer Commission (ACCC)
- Australian Energy Regulator (AER)
- Essential Services Commission of South Australia (ESCOSA)
- Essential Services Commission, Victoria (ESCVic)
- The ACT Independent Competition and Regulatory Commission (ICRC)
- Independent Pricing and Regulatory Tribunal of NSW (IPART)
- Queensland Competition Authority (QCA)
- Economic Regulation Authority of Western Australia (ERA)
- Northern Territory Utilities Commission
- Office of the Tasmanian Energy Regulator (OTTER)
- Tasmanian Government Prices Oversight Commission (GPOC)

As the Prime Minister's Taskforce report noted:

> *The complexity of rail regulation was detailed by Patrick Corporation. It advised the taskforce that an operator of interstate trains may, potentially, have to deal with:*
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> - *7 rail safety regulators with nine different pieces of legislation;*
> - *3 transport accident investigators;*
> - *15 pieces of legislation covering occupational health and safety of rail operations;*
> - *6 access regulators; and*
> - *75 pieces of legislation with powers over environmental management.*[6]

The establishment of the Australian Energy Regulator as a one-stop shop for energy regulation will shortly cut through this maze in gas and electricity. But it should be noted that as of right now, the Australian Energy Regulator is simply an additional regulator on top of the 9 state and territory bodies.

So it's clear that much more could be done to speed up the process of regulation in Australia by clearing away the multiple layers of regulation and multiple levels of appeal.

In short we need to go back to the spirit of Hilmer and have a national approach to nationally significant infrastructure. While state regimes might have been useful for the transition phase, it is now time that we move to a national approach.

As a first step, for facilities of 'national significance', all access decisions should be made by the Commonwealth Minister replacing the concept of an 'effective State or Territory access regime', as currently provided under Part 111A of the Trade Practices Act. While there would still be scope for state regimes in some circumstances, this change would ensure that facilities of 'national significance' were not exempted from coverage under the national regime.

[6] *"Australia's Export Infrastructure" Page 49*

Secondly, we should remove the requirement for re-hearing of decisions. Currently, the Minister's decision to declare a service or certify an access regime, as well as the arbitrator's decision on terms and conditions, is subject to re-hearing in the Australian Competition Tribunal.

This is not to suggest that regulators should not be accountable, or that errors or unreasonableness should not be subject to review. But rather than rely on review processes, we should ensure that the original decision-making body has the expertise to generate confidence in its decisions. There will always be arguments and challenges by vested interests, but the reality in a relatively small country such as Australia is that there is too little relevant infrastructure expertise available to divide it amongst a range of administrative bodies. The AER provides a good model in this respect.

I've talked until now about what can be done to streamline and improve regulation, which is crucial for ensuring that investment by business is decided on commercial grounds, and not by the height of the regulatory hurdles.

But we also recognise that in many parts of Australia, vital infrastructure is not always commercially viable, and that some form of government intervention may be necessary to ensure essential services are delivered. And the hot button issue here at the moment, is, of course, Telecommunications.

Telecommunications infrastructure investment

Since the opening up of the telecommunications market to full competition in July 1997, new investment in telecommunications infrastructure has totalled more than $24 billion, and in 2003-04 alone more than $2.5 billion was invested. Investment in mobile network infrastructure accounted for almost half of this amount (44 per cent), followed by local access networks (35 per cent), transmission networks (14 per cent), xDSL services (6 per cent), and ISDN services (2 per cent).

Investment in telecommunications infrastructure tends to be cyclical, so it is difficult to draw conclusions based upon annual figures. But it is clear that in 2004 Telstra continued to invest significantly more than other carriers, and that carriers are continuing to invest in infrastructure used to supply fixed-line services – PSTN, ISDN, and xDSL – as well as infrastructure used to supply mobile services.

The ACCC's annual survey of data from licensed carriers also indicates the likelihood of increasing investment in the next year, particularly in xDSL infrastructure. Meanwhile, Telstra's CEO recently announced that Telstra's capital expenditure is forecast to increase to about $4 billion this year from $3.3 billion last year, with much of this understood to be spending on an overhaul of its networks.

The expansion of infrastructure has brought significant benefits to consumers. There has been a general downward trend in the prices of most call services with the price of an average basket of telecommunications services falling by

20.1 per cent in real terms between 1997–98 and 2002–03. And in the year since the ACCC intervened in the ADSL pricing case, broadband take-up has exceeded 1 million – a massive 120 per cent increase in just 12 months.

Importantly, the explosion in broadband customers has been shared by both Telstra and its wholesale competitors.

Broadband take up has now reached the point where it is becoming increasingly viable for access seekers to roll-out their own DSL infrastructure into a larger number of Telstra's exchanges.

These outcomes highlight the benefits that are possible through infrastructure-based competition. Whereas the initial benefits of the current telecommunications regulatory regime were almost entirely due to competitors entering at the retail level and making use of regulated interconnection to drive down retail costs, the more competitive, innovative areas are those in which competitors have built their own networks, rather than just reselling space on Telstra lines.

But despite these positive results, we recognise that in some parts of the country, especially the more remote areas, there may be an under-provision of services. It is well recognised that the unregulated supply of natural monopoly services – which many infrastructure services are – often will be less than is socially optimal.

Yet aside from the market failure associated with natural monopoly, it may be simply uneconomic for any privately owned company to provide infrastructure-based services to some locations. For these reasons governments often take the view that some intervention is required. This may take the form of subsidies to consumers, subsidies to service providers, or the imposition of community service obligations (CSOs) or universal service obligations (USOs) on service providers.

As a general principle, governments should be encouraged to intervene in a way that minimises any distortions to competition. That is, subsidies should not favour one competitor over another, and government funding for legitimate social policy purposes should avoid entrenching or extending the existing market power of a dominant incumbent firm.

In this respect, telecommunications services are a topical case in point, and from a competition perspective, it is encouraging to see that the Government's recent commitment to $1billion of funding of rural and regional communications services are to be delivered on a competitively and technologically neutral basis.

I understand that all broadband service providers will have access to the subsidies, and that this program will also be used to support the rollout of new wireless, satellite, fibre and high speed copper broadband infrastructure, by leveraging subsidies against private investment in marginal locations.

This is consistent with the idea of allowing the competitive process to determine which technologies, delivered by which firms, best meet consumer needs at the lowest possible cost. Such an approach should always be preferred to a straight handover to an already powerful incumbent.

But though our stocktake of infrastructure investment reveals good results in telecommunications, some critics still argue that investment and innovation in Australia's telecommunications network, including extensive broadband deployment, is hindered by regulation.

Not surprisingly, the ACCC takes a different view.

The overriding issue in this industry is the dominance of the telecommunications sector by just one player - Telstra - by virtue of it being the sole provider of the ubiquitous local access network connecting virtually every home and business in the country. This monopoly means that even in the more competitive markets, those seeking to compete with Telstra continue to rely on Telstra for some form of access to its network.

If anything, the current regulatory regime provides insufficient constraints on pricing of monopoly services. For example, Telstra's proposed prices for critical unbundled local loop services (ULLS) may well discourage efficient investment in, and use of, infrastructure by both Telstra and access seekers. In the recent draft decision on Telstra's ULL and LSS monthly charge undertakings, the Commission suggested that the costs of establishing ULL and LSS services should be spread more broadly rather than loaded onto the first customers of these services.

But if Telstra's latest financial reports are anything to go by, it would appear that access regulation is making the right impact. Telstra's declining margins for its local access network indicate that although the PSTN remains a bottleneck service, and the main source of Telstra's monopoly rents, increased competition has forced Telstra to stay ahead of the competition by offering new services.

And despite Telstra's recent comments, I would argue that it's not regulation that keeps Telstra from investing. As I have mentioned, the problem remains that, due to its monopoly over the local access network, Telstra can choose when it will respond to a competitive challenge. It appears that when competitors indicate plans to rollout certain infrastructure, for example DSLAMS that would provide higher speed broadband services, Telstra makes its own competitive response. That's all part of the benefits of competition. If access regulation makes it possible for competitors to invest in infrastructure, while also encouraging (or at least not deterring) Telstra, then that is a good outcome. In a competitive environment, any investment shortfall by Telstra is likely to be offset by increased investment by Telstra's competitors.

The Government's proposed model for operational separation of Telstra maintains the balanced approach of the existing regulatory regime, and recognises that Telstra is in the unique position, through its monopoly over the local access network, of being able to stifle innovation by frustrating its competitors' investment plans.

For this reason, the ACCC welcomes changes which should increase transparency and equivalence in the way Telstra provides key access services to its own downstream operations relative to those of its competitors. Most importantly, these changes should complement the checks and balances of the well-established and thoroughly reviewed regulatory regime.

And despite the scepticism of some commentators, the Government's program is not designed to undermine Telstra's value, but rather to ensure that its fixed network monopoly (which Telstra itself concedes should still be subject to regulation) is operating in a transparent way. Telstra should have nothing to fear from this, as such transparency should provide it with a much more certain starting point for verifying that Telstra is competing on a fair basis.

Indeed, the equivalence obligations reflect the principle that a more level playing field enhances the efficiency of the telecommunications industry, and shouldn't affect an efficient Telstra's ability to invest, compete or prosper. Telstra's prospects lie in its own hands.

If the final operational separation model reflects the Government's intentions for increased transparency and equivalence, Telstra's competitors will be in a better position to see the terms and conditions for network access that Telstra offers to its own retail units and compare these to the terms and conditions they themselves face. This will improve transparency and certainty for Telstra's competitors, and is likely to be conducive to more investment in telecommunications services overall.

The only thing that Telstra should fear is the threat of competition. The quality of its responses to emerging competition will, alone, determine Telstra's prospects and value to shareholders.

Dalrymple Bay & Port Waratah

Finally, I'd like to turn to the issue which really focussed attention on the debate about whether regulation was creating an infrastructure crisis, Port Waratah and Dalrymple Bay.

The huge queue of ships off both these ports waiting to load coal was used as a fairly heavy club to batter government regulators. As both the Prime Minister's Taskforce and the Allen report found, the principle reason for the queue was actually an unexpected spike in demand for Australian coal, although this was exacerbated at Dalrymple Bay by a long standing dispute between the port operator and the coal producers.

But in both cases, the ACCC was able to respond quickly to industry proposals for transitional measures to reduce the excessive queues and save coal producers millions of dollars in deadweight demurrage costs until coal chain expansion projects enable the ports to cope with greater volumes of coal.

- ***Port Waratah Coal Services Ltd***

On 1 October 2004 Port Waratah Coal Services sought authorisation of a proposed medium term capacity distribution system to reduce the imbalance between the demand for coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain.

The imbalance, caused by coal producers taking advantage of a spike in world prices, and agreeing to sell more coal than the terminal could handle, led to a huge queue of ships off the port, and significant demurrage charges being levied by ship owners on coal producers.

The solution was to provide coal producers with the option to accept a pro-rata reduction in coal export contracts, or participate in a demand auction, in the event that demand for coal shipping services on the Hunter Valley coal chain exceeds available capacity by 3 million tonnes.

On 3 November 2004 the ACCC granted interim authorisation to run the demand reduction auction and on December 16 a draft decision proposing to grant authorisation to allow Port Waratah Coal Services to effectively commence the introduction of the system from 1 January 2005, as requested.

Around six months after the application was lodged, on 15 April 2005 the ACCC issued its final decision. The ACCC concluded that the capacity distribution system would likely result in significant public benefits particularly by reducing demurrage costs and improving economic efficiency.

The ACCC was also satisfied any public detriment arising from a reduction of the volume of coal moved through the coal chain is likely to be negligible and was satisfied that the Medium Term capacity distribution system would not remove the pressure to invest in expanding the capacity of the Hunter Valley coal chain, including at the port.

To help safeguard against under-investment, the ACCC only granted authorisation until the end of 2007, and Port Waratah Coal Services is required to report annually on the progress of the capacity expansion program. Soon after receiving authorisation, Port Waratah Coal Services announced $170 million expansion at the port to increase capacity from 89 million tonnes per annum to 102 million tonnes by the end of 2007.

- ***Dalrymple Bay Coal Terminal***

On 5 April 2005 the ACCC received an application for authorisation from Dalrymple Bay Coal Terminal Pty Limited in relation to a proposed queue management system to address a similar imbalance between demand for coal loading services and the capacity of the Goonyella coal chain.

The system essentially rations the amount of coal each producer can export through the Terminal on a pro rata basis so that the overall capacity of ships arriving better matches the amount that can be delivered by the congested coal chain.

Around the time the application was lodged, the capacity imbalance had led to a large queue of up to 50 vessels sitting off the coast. Like the Port Waratah matter, the ACCC moved quickly under the authorisation process and was able to grant interim authorisation for the scheme in under a month on 29 April 2005. During July 2005 the industry reviewed the operation of the scheme to assess whether any changes to the system were warranted. Following this review, on 5 August 2005 Dalrymple Bay Coal Terminal sought to make minor operational amendments to the system and the ACCC agreed to this on August 10.

The industry is continuing to conduct an extended review of the operation of the Queue Management System under the protection of interim authorisation.

The ACCC acted quickly in both these matters to allow the industry to address inefficiencies. For instance, at Dalrymple Bay the ACCC responded to a request for interim authorisation within 24 days of receiving the application.

Protecting the Gains

If the regulatory regime is really deterring investment then the data should surely demonstrate investment lagging across the utility sectors, whether it be gas, electricity transmission or telecommunications. It should also show that those who nevertheless ignore the doomsayers should be making a poor return on their investments.

In fact, the opposite is the case – telecommunications, gas and electricity transmission are recording unprecedented levels of capital expenditure under the regulatory regime and those who do make these investments are out performing other sectors of the economy.

And, as was showed in the Port Waratah and Dalrymple Bay matters, regulation is able to act quickly to deal with short term capacity constraints, while planning for the longer term.

As the Allen Consulting Group concluded in its report to the ACCC on the impact of regulation on investment:

> *In summary, there is no evidence to suggest that Australia's regulatory framework is deterring investment in regulated utilities. On the contrary, the regulated utilities sector has relatively strong investment fundamentals, whether compared to the Australian market or internationally.*[7]

Ratings agencies have been just as positive about the prospects of regulated companies over the next three to five years. Moody's noted "the supportive regulatory frameworks ….. and stable operating and financial profiles"[8] while Standard and Poor's noted the "transparent and supportive regulatory

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[7] *Review of Studies Comparing International Regulatory determinations*. Final Report prepared by Allen Consulting Group for ACCC, 2004, page 124

[8] *Australian/NZ Regulated Distribution and Transmission 2003 Outlook.* Moody's Investors Service, July 2003, p. 1.

regime"[9]. Similarly, Fitch Ratings stated "the current regulatory regime appears relatively supportive for transmission entities"[10].

So, as I said at the outset, Australia does not have an infrastructure crisis. Infrastructure regulation in Australia has led to significant gains for consumers, business and the economy as a whole.

We need to move on from this debate and instead continue to look for ways to improve regulatory arrangements and practices to promote investment in essential national infrastructure in the long term interest of the nation.

This includes streamlining the regulatory process on a nationally consistent basis that minimises the scope for regulatory gaming and attendant time delays and uncertainty.

But it also involves the private sector taking a lead role in investing in and developing infrastructure facilities, leaving it to Government to provide the resources for dealing with genuinely economic, but socially desirable community or universal service obligations.

[9] *Australian Report Card: Utilities,* Standard and Poor's, 6 October 2003, p.7.
[10] *Australian Electricity Sector: At That Awkward Adolescence Stage*, Australia Special Report, Fitch Ratings, 24 March 2004, p. 39.