South Australian Centre for Economics Studies

Australian Infrastructure Reform: Where to from here?

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Introduction

Ten years after the implementation of competition policy reforms Australia's infrastructure environment has been massively changed:

- private sector involvement has increased dramatically through both privatisations and various forms of public/private partnerships
- structural reforms have occurred
- State and Commonwealth governments are involved in new regulatory roles, and
- infrastructure performance has become highly contentious – a front page issue for both government and business

Further, in newspaper articles and in numerous public reports, fundamental issues about the purpose of regulation as well as issues about design and regulatory practices are being raised.

How did the subject of infrastructure regulation become this interesting?

National Competition Policy

The National Competition Policy reforms were a major change to Australia's microeconomic framework. Competition was introduced into formerly sheltered areas of the economy such as state run electricity businesses, gas pipelines, airports and rail links. The *Trade Practices Act 1974* (the Act) was extended to cover almost the entire economy, and structural and legislative impediments were removed to facilitate competition in the non-traded goods sector.

A raft of governance and structural reforms to government infrastructure businesses followed. Infrastructure businesses were made more commercially focussed:

- monopoly elements of a business were separated from the contestable service elements

- the contestable elements were to be subject to greater competitive pressures

- to curb the market power of the monopoly elements, prices oversight and regulatory arrangements to secure third–party access to 'essential' services were introduced.

As part of the reforms process the Australian Competition and Consumer Commission (the ACCC) was created. And of course here is the paradox.

Competition delivers the best outcomes in 'free' markets. Yet to achieve the reforms of National Competition Policy independent regulation in the Australian economy has been increased.

The competition & regulatory mix

By implementing National Competition Policy governments adopted the Hilmer Committee's philosophy that through competition, firms and institutions would become more efficient, innovative and flexible. Consumers would have greater choice and possibly lower prices. Competition was recognised as a means of enhancing community welfare by promoting a more efficient use of resources, thus providing greater returns to producers and higher real wages.

Competitive markets usually deliver good outcomes because they act to align the interests of consumers and suppliers.

In seeking to maximise profits, suppliers have strong financial incentives to produce at the lowest cost, to provide the mix and quality of goods and services required by consumers and to innovate in order to achieve a competitive edge. Provided that certain threshold conditions, such as secure and enforceable property rights exist, competitive markets work by themselves.

Markets that work in this way are the aim. However, we must be realistic for it is not always possible for markets to work effectively, especially in the areas of infrastructure provision where there are, and have been, monopoly providers. For some markets increased competition can only be achieved with increased regulation. This is the paradox recognised by the National Competition Policy reforms.

Introducing competition in some markets requires a staged reform process and much more than just the removal of legislative restrictions on competition.

New entrants seeking to enter an opened-up contestable part of the market, say for the carriage of minerals or other natural resources, need to be sure that they can get access to the essential facility, namely, the rail track. Building a new state-of-the art track would be uneconomic when there is already one in place.

To create competition, access provisions are therefore required and this has meant a regulatory framework that oversights access conditions, including negotiations to determine access prices. This can be the high end of regulatory intervention.

For some other types of infrastructure services the conditions can emerge that allow the discipline of the market to take over from the role of the regulator.

Getting the timing right to free markets from regulation when the signs of competition are emerging is a challenge that regulators face.

There is no doubt that significant intervention – which is what determining access prices requires - and the impatience by some parts of business for the regulators to get out of the market, has created an enormous interest in infrastructure regulation.

Some results

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"[1].

In Australia, Productivity Commission estimates show that the observed productivity and price changes in Australia's key infrastructure sectors have boosted our GDP by around 2.5 per cent or $20 billion above our long term growth path[2]. The Productivity Commission found that lower prices and increased quality and reliability, particularly in the provision of infrastructure services, have underpinned this growth.

These are great outcomes and much has been achieved. However, we have to press on with reforms and take stock of what we can do better.

We have no alternative than to do better, for regardless of past achievements, regulators are under great scrutiny and the stakes have become higher. The efficient operation of infrastructure is a prerequisite to operating in a globally competitive economy.

Contentious issues in infrastructure regulation

For my talk today I would like to focus upon what I see as four contentious and critical issues in infrastructure regulation:

- achieving a national approach to infrastructure regulation

[1] OECD Economic Survey of Australia 2004 Policy Brief January 2005. Page 2
[2] *Review of National Competition Policy Reforms* Productivity Commission Inquiry Report No 33. February 2005. Page XVII

- the impact of regulation on investment decisions
- achieving regulatory decisions that work in-step with commercial imperatives, and
- the role for 'light handed' regulation

Achieving a national approach to infrastructure regulation

A key driver behind competition reforms for infrastructure industries was the realisation that the more efficient delivery of these services on a domestic level would enhance Australia's international competitiveness.

To be competitive internationally Australia must be competitive at home and that has to mean that Australian businesses should be able to move seamlessly between the States in the course of their business activities. But the objective of a truly national approach to competition issues across jurisdictions and markets is yet to be fully realised.

The competition policy reforms of the mid 1990s were intended to establish a national approach to competition issues across jurisdictions and markets. The reality, however, is that there has been a proliferation of different access regimes at the State and Territory level.

There are currently over 20 State-based regimes in operation covering rail, ports, gas and electricity and 11 Federal, State and Territory economic regulators:

- ACCC
- Australian Energy Regulator
- Essential Services Commission of South Australia
- Essential Services Commission, Victoria
- ACT Independent Competition and Regulatory Commission
- Independent Pricing and Regulatory Tribunal of NSW
- Queensland Competition Authority
- Economic Regulation Authority of Western Australia
- Northern Territory Utilities Commission
- Office of the Tasmanian Energy Regulator

Last year the Prime Minister's Export Infrastructure Taskforce highlighted this issue and the potential effect that a proliferation of regulators is having in

industries such as rail[3]. The Council of Australian Governments (COAG) has now responded and at their most recent meeting (February 2006) a reform agenda was proposed to achieve a more national approach to infrastructure regulation. Under this agreement COAG agreed to:

- establish a simpler and consistent approach to economic regulation of significant infrastructure
- certify all state and territory access regimes for services provided by significant infrastructure (to be completed by the end of 2010)
- develop a streamlined process for certification
- develop a consistent national system of rail access regulation
- review port regulation to determine if economic regulation is warranted to promote competition. Where economic regulation is warranted at significant ports it should conform to a consistent national approach

We need to go back to the spirit of Hilmer and have a national approach to nationally significant infrastructure.

A national approach is required for facilities of national significance. We hope that the establishment of the Australian Energy Regulator (which has been established within the ACCC) as a one-stop shop for energy regulation will cut through the maze in the gas and electricity sectors.

The impact of regulation on investment decisions

Given the fundamental importance of infrastructure to Australia's well-being, it is crucial that regulation provides an environment that is conducive to efficient investment in the industry.

Last year there was considerable discussion about whether regulation impedes investment. CEDA[4] and the Business Council of Australia have produced reports[5]. The Allen Consulting Group report commissioned by the Victorian Government[6] and the Commonwealth's Export Infrastructure Taskforce have added to the public debate[7].

[3] "*Australia's Export Infrastructure*" report to the Prime Minister by Australia's Export Infrastructure Taskforce, May, 2005, Page 49.
[4] "*Infrastructure : Getting on with the Job*". Committee for Economic Development of Austrlaia April 2005.
[5] "*Infrastructure action plan for future prosperity*" Business Council of Australia March 2005.
[6] "*Investing in Australia's economic infrastructure*" Report to the government of Victoria prepared by the Allen Consulting Group, May 2005.
[7] "*Australia's Export Infrstructure"* report to the Prime Minister by Australia's Export Infrastructure Taskforce, May 2005.

I have already made my position clear on the issue about an infrastructure crisis – all the evidence points to there being none. Rather it is important to assess:

- whether the data demonstrates that investment is lagging across the utility sector, and
- whether investment is making poor returns

I have not seen any evidence that economic regulation as practiced in Australia has had a negative impact on investment.

Taking energy for example, energy infrastructure investment since the implementation of the National Competition Policy has been remarkably high. Capital expenditure on new gas pipelines has increased substantially, including the construction of:

- Eastern Gas Pipeline: Longford (Vic) to Sydney
- Tasmanian Gas Pipeline: Longford (Vic) to Tasmania
- SEA Gas Pipeline: Port Campbell (Vic) to Adelaide
- North Queensland Gas Pipeline: Moranbah to Townsville, and
- 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, and
- 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 is likely to satisfy most of the additional demand for gas

and probably result in there being no need for any 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. Most recently, 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.

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

Of course, incentives for investment under regulation and under different types of regulation are issues where continued vigilance is required. Undoubtedly there are 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.

We are committed to running transparent regulatory processes. To this end, we communicate the objectives underpinning regulation to industry. We invite stakeholders to provide submissions so that we may make judgements from an informed perspective. We issue draft decisions and competition assessments which explain the evidence and reasoning that the ACCC has taken into account in coming to a particular position. By consulting with industry in this way, we provide opportunities for our reasoning to be corrected.

Also, amendments to existing legislation have been/are being made to highlight the incentives required for efficient investment. With regard to the national access regime (Part IIIA) this includes new objects clauses, pricing principles and immunity from declaration for services delivered by government-sponsored infrastructure where the ACCC approves the tender process.

It is critical that regulators do their job thoroughly, responsively, and are accountable for their decisions. However, given the absence of perfect information, we can not pretend that regulatory outcomes will be perfect.

Achieving regulatory decisions that work in-step with commercial imperatives

The ACCC recognises and is appreciative of commercial imperatives faced by many firms. This is certainly a critical issue that we are facing today with regard to discussions with Telstra regarding their proposed investment in a high bandwidth access network (typically referred to as the Fibre-To-the Node (FTTN) Network).

Changes made to the Trade Practices Act in 2002 provided for 'special access undertakings' to help the regulator to stay in-step with commercial imperatives. Under Part XIC, the Telecommunications Access Regime, undertakings can be offered before an investment is made in new

[8] Australian/NZ Regulated Distribution and Transmission 2003 Outlook. Moody's Investors Service, July 2003, P. 1.
[9] Australian Report Card: Utilities, Standard and Poor's, 6 October 2003, Page 7.
[10] *Australian Electricity Sector: At That Awkward Adolescence Stage*, Australia Special Reort, Fitch Ratings, 24 March 2004, page 39.

infrastructure. These provisions recognise that some level of regulatory certainty is required if commercial decisions are to be made about new investments.

However it is the issue about timeliness that attracts most attention. The issue which really focussed attention on the debate about whether regulation was creating an infrastructure crisis was the vessel queues at Port Waratah and Dalrymple Bay.

Regulators must be conscious of the need to move quickly to meet fast changing circumstances, such as a bottleneck at a port caused by a sudden unexpected spike in the demand for coal. The ACCC has demonstrated its responsiveness to commercial flashpoints in acting to address such matters.

The large queue of ships off both these ports waiting to load coal was used as an example of where regulation had not only failed but created an infrastructure crisis. As both the Taskforce and a report for the Victorian Government by the Allen Consulting Group 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 disagreement between the port operator and the coal producers.

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.

At Port Waratah the interim 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.

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

At Dalrymple Bay the ACCC granted interim authorisation to a queue management system to address a similar imbalance between demand for coal loading services and the capacity of the Goonyella coal chain which had led to a queue of up to 50 ships off the port.

In both these matters the ACCC acted quickly to allow the industry to address urgent issues of inefficiencies. For instance, at Dalrymple Bay the ACCC responded to a request for interim authorisation within 24 days of receiving the application. As a regulator the ACCC understood the need for action to quickly overcome the problem of infrastructure constraints. As the body administrating competition law it was able to act quickly.

In recognition of commercial imperatives, statutory time guidelines – usually of six months – are increasingly being introduced for ACCC regulatory decisions. COAG agreed in February this year to introduce six month (by 2008) binding time limits for access decisions.

However, to make time limits effective the regulator and the regulated must achieve more common ground:

- for the regulator information asymmetry is a critical constraint in any decision making, and

- ambit claims reduce the speed of regulatory decisions.

Also, a balance needs to be struck between accountability (the review of the decision) and timeliness. Multiple levels of reviews can delay the decision making process for years.

The declaration of airside services at Sydney airport is the most spectacular example here. This matter first began with application to the National Competition Council in August 2002. There was a draft report in June 2003 and final report in November, a ruling by the minister in January 2004, and then the whole thing went on review to the Australian Competition Tribunal (the Tribunal) with a decision made in favour of declaration in December 2005. That decision has been appealed to the Federal Court and we are awaiting the Court's decision.

Almost two of the three and a half years that it has taken (so far) to achieve this outcome were taken up with the review process. If the Federal Court rejects the appeal and the declaration is maintained there is then a negotiating process which could take six months to a year. If there's no agreement the ACCC arbitrates, and if one of the parties is unhappy with our ruling they can have that reviewed by the Tribunal. Again, each of these steps is open to an appeal in the Federal Court.

By my count it may well be 2010 before this process is complete!

Of course, in competition and regulatory matters, decisions are rarely simple. They require the regulator to make complex economic judgements and to balance criteria that are often in competition with each other. They often involve lengthy investigations to obtain input from a wide range of interested parties. It is usually difficult to repeat this type of process before a tribunal.

Governments have recognised these concerns. In the recently issued COAG Communiqué, it was announced that where merits review of regulatory decisions is provided for, the review will be limited to the information submitted to the regulator. This is already a feature of merits review of some ACCC decisions relating to gas pipelines and telecommunications networks. A limitation on new evidence does tend to shorten the time taken by merits review.

It is very important to be clear about the distinction between the two different forms of merits review. In the case of full merits review, new evidence is able to be considered including changes in circumstances after the decision is made. This was the case in the Tribunal's decision in the Qantas/Air New Zealand matter.

In such circumstances the Tribunal becomes an avenue for making a new decision. This encourages forum shopping.

Those who favour full merits review argue that by presenting new or additional evidence a decision can be made on the basis of using the most up-to-date information. This is quite inappropriate. Should new evidence come to light, *or* if circumstances have shown past 'facts' to be different, the place to assess this new evidence is not before the Tribunal - the decision should be returned to the regulator.

With limited merits review, the review is on the basis of existing evidence. The role of merits review is then to assess whether the regulator, on the basis of the evidence before it, made a mistake. Merits review ought to be used to correct mistakes not to provide yet another forum for yet another decision.

It is for this reason that the move to limited merits review, or to say the same thing, 'a review on the papers', is an important reform for infrastructure regulation in Australia.

Governments, regulators and industry participants will no doubt watch with interest to see if this form of restricted merits review is able to help achieve a better balance between timeliness and accountability for all industry participants.

None of these remarks are intended to suggest that regulators should not be accountable, or that errors or unreasonableness should not be subject to review. Review is an essential check and balance to the power of the regulator. If parties to a regulatory decision are concerned that the principles laid down by Parliament in legislation have not been followed by the regulator, the concerned parties must have the opportunity to have the decision reviewed.

Mention should also be made of judicial review, which is generally undertaken by the Federal Court. It allows courts to scrutinise the regulator's conduct and to ensure that it is performing its functions and exercising its powers according to law. It applies to all decisions made by the regulator. It is not settled whether judicial review applies to decisions by the ACCC to commence legal proceedings for a contravention of the Act. However, the ACCC will always need to prove the merits of such a case to the court.

It does not do justice to judicial review to simply state that it is concerned with the legality of the ACCC's actions. The *Administrative Decisions (Judicial Review) Act 1977* sets out a long list of grounds upon which an ACCC decision can be reviewed. These include a denial of natural justice, a lack of evidence, unreasonableness, improper purpose and bad faith.

While judicial review does not allow courts to review the merits of a decision, in modern administrative law the line between judicial and merits review has become increasingly blurred. For example a claim commonly made is that the regulatory decision is fundamentally unreasonable and therefore subject to judicial review. This can lead the Court to a *de facto* merits review of the decision to determine if it is unreasonable. A recent example of a claim of this nature was the appeal last year by Vodafone against pricing principles made by the ACCC under Part XIC of the Trade Practices Act.

To put all this in context our fundamental aim should be to achieve the right balance between accountability and timeliness. For the effective operation of the economy as a whole we need to think very carefully about the impact on commercial arrangements of our decision making and review processes.

The role for 'light-handed' regulation

A number of reports and reviews, including last year's Prime Minister's Export Infrastructure Taskforce review, have emphasised the role of 'light handed' regulation and within this context the role of price monitoring.

'Light handed' regulation is seen to be a way of reducing compliance cost, especially in terms of the information requirement that access regimes ('heavy handed' regulation) require. The risk of distortion to investment incentives created by 'heavy handed' regulation could be reduced if a monitoring regime is in place – or so the argument goes.

Without qualification, the objective of regulation/oversight should always be to achieve effectiveness (the desired outcomes) by means that are as 'light-handed' as possible. If an objective can be achieved with less rather than more intervention this should be the approach adopted. Given this, what is the role for monitoring?

The ACCC does a lot of monitoring. The products and sectors monitored are diverse. The nature and purpose of the monitoring is different. Currently, Australia's major airports are subject to price monitoring by the ACCC.

Monitoring can be important in providing the community with certain types of price information. It can also provide performance information to government about, for example, structural changes in particular sectors of the economy. This information may help government determine the nature of future oversight arrangements.

Context is all important with the fundamental question being - what is the purpose of the monitoring?

COAG has recently considered this issue regarding the regulation of significant infrastructure facilities.

First, where possible, third party access agreements should be commercially agreed.

Price monitoring should be considered:

- where it can improve the level of price transparency
- as a first step where price regulation may be required, or
- when scaling back from more intrusive regulation

Where 'light handed' regulation is not possible access regimes should promote efficiency and should also try to achieve national consistency.

If the purpose of government intervention is to curb the market power of a monopoly infrastructure asset, 'light handed' monitoring cannot be the mechanism to use. To increase allocative (*price*), technical (*cost*) and dynamic efficiency of the monopoly business, a different type of regulation is required.

If the regime is called monitoring it will be in name only. Information requirements in terms of both collection and specification of data would be considerable. Performance outcomes would have to be oversighted and presumedly some triggers for non-performance would have to be put in place creating some type of shadow regulation.

If the purpose of regulating a monopoly facility is to curb the market power of that facility, to be effective the 'monitoring' program will not be 'light handed' at all. It will be 'heavy handed' regulation in disguise. That is, it is 'heavy handed' regulation minus a certain transparency.

Regulatory mechanisms and purpose have to match up.

Conclusion

Work by American economists in the late 1980's pointed to the relationship between infrastructure and economic growth. Following this work a significant body of research was undertaken including Australian studies, to determine the numerical relationship between infrastructure and the impact on GDP. These studies highlight the importance of quality infrastructure for a nation's productivity and economic growth.

The ACCC is charged with regulating many of Australia's major infrastructure assets. Therefore let me conclude by summarising what I see as the key positions of the ACCC on the critical regulatory issues that I have discussed today.

The ACCC is pro competition and believes that competition within the market is the best means of achieving the greatest welfare benefits for Australians. Indeed competition underpins the Trade Practices Act. However, it has to be recognised that intervention in some markets is required before market disciplines can be relied upon to achieve the efficient use of resources. Here regulation can play a valuable role.

The ACCC will continue to hone its regulatory practices to achieve effective outcomes. While much has been achieved in infrastructure reform there is still much that needs to be done:

- the drive towards a national approach to the regulation of nationally significant infrastructure is welcomed

- incentives for investment under regulation and under different types of regulation are issues where continued vigilance is required. Undoubtedly there are 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 ACCC recognises and is appreciative of commercial imperatives faced by many firms and is committed to achieving timely outcomes, and

- the objective of regulation should always be to achieve effectiveness (the desired outcomes) by means that are as 'light-handed' as possible. If the purpose of government intervention is to curb the market power of a monopoly infrastructure asset, 'light handed' monitoring will not be the mechanism to use.