Business Council of Australia

Submission to the Productivity Commission Inquiry into the National Access Regime and the Competition and Infrastructure Reform Agreement

JULY 2013

Working to achieve economic, social and environmental goals that will benefit Australians now and into the future

Contents

The Business Council of Australia (BCA) brings together the chief executives of more than 100 of Australia's leading companies, whose vision is for Australia to be the best place in the world in which to live, learn, work and do business.

About this submission

The BCA is making this submission in response to the release of the Productivity Commission's Draft Report on the National Access Regime (NAR) and the Competition and Infrastructure Reform Agreement (CIRA).

This is an important review for configuring Australia's infrastructure policies to capture growth opportunities, promote efficient investment in infrastructure and grow the welfare of Australians. In March the BCA made an initial submission supporting recommendations to:

- ensure infrastructure regulation settings strike the right balance between competition and investment incentives, and ensure the benefits of the NAR clearly exceed its costs
- promote investment through greater regulatory certainty for investors
- reduce the costs and risks that can stem from inefficient procedures, poor decision making and regulatory failures.

The BCA agrees with most of the commission's draft findings and recommendations. Our comment on each recommendation is provided in Appendix 1. The discussion below adds further comment on four areas in the draft report of key interest to the BCA: the analysis of the costs and benefits of the regime; the proposal to use a natural monopoly test rather than a private profitability test; the regulatory power to direct extension (or expansion) of facilities, and the CIRA.

Key recommendations

- The commission should include a formal finding on its assessment of the costs and benefits of the NAR in its final report, including its assessment (if it remains the case) that "it has not been possible to quantify the economic impacts of the regime or its effect on economic growth and productivity".
- The commission should, where practicable, make explicit findings and recommendations in its final report against terms of reference Item No. 4 which requires it to "provide advice on ways to improve processes and decisions for facilitating third party access to essential infrastructure". In particular we would like to see explicit findings and recommendations against two sub-points under Item No. 4:
  - "measures to improve flexibility and reduce complexity, costs and time for all parties" by undertaking further empirical investigation of the costs associated with the NAR and identifying specific recommendations to reduce those costs for participants. Reducing costs is especially important given the ambiguous findings about benefits.
  - "'greenfield' infrastructure projects and private sector infrastructure provision" by recommending ways to improve certainty around the application of access regulation to greenfield infrastructure projects, for instance, improved application of the ineligibility provisions.
- The final report should strengthen the assessment of the two possible tests being considered under criterion (b) – the natural monopoly test and the private profitability test – and provide a stronger case before arguing for a shift to a natural monopoly test, including by:
  - reconciling the commission's Draft Finding 3.1 that "In markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service), allowing competition between providers will generally be preferable to access regulation …" with the arguments for the commission's preference for a natural monopoly test to replace a private profitability test in Chapter 5 and in Recommendation 8.1

  - the commission undertaking its own empirical testing of the practicality of the natural monopoly test and the private profitability test, and reporting the results. This can build the evidence base for the commission's final assessment about the workability of each test, and inform and help settle the wider debate around the two tests.

- We agree with the commission's view that there should be clarity in the Act about whether the ACCC should have the power to direct expansions of facilities. However, any powers to expand the capacity of facilities should be subjected to a thorough and rigorous supporting cost – benefit analysis that demonstrates a clear net economic benefit. We recommend the final report should make clear that direct negotiation is greatly preferred to regulation, not 'generally preferred' as stated, to properly reflect the significant costs and risks from a regulator directing investment.
- Guidelines for how the ACCC should apply any facilities extension (or expansion) powers as recommended by the Commission would be helpful, however, as the body exercising the powers the ACCC should not be solely tasked with developing the guidelines. Rather:
  - the commission should set out its own set of guiding principles for the use of facilities extension (or expansion) powers in its final report, including setting a clear preference for negotiated outcomes and incentives for achieving that outcome
  - an independent advisory panel should be established to make recommendations on the development of any guidelines, made up of access regulation experts and business participants.
- Recommendation 10.1 should urge governments to review their competitive neutrality policies within the next 12 months.
- Draft Finding 10.2 should be made a recommendation to encourage governments to put in place appropriate regulatory arrangements to enable the transfer of infrastructure assets to the private sector.

The Commission's assessment of the costs and benefits of the National Access Regime

The Commission has said that the objective of the NAR should be to address market failure due to 'a lack of effective competition in markets for infrastructure services due to natural monopoly'. The draft report provides a considered evaluation of whether the NAR remains the best tool to meet this objective. The report finds that revoking Part IIIA 'may do more harm than good' given its 'backstop role' and that it acts as an 'overarching framework' for other access regimes.

As stated in our initial submission, the BCA agrees that the NAR plays an important role and supports this finding but that we would be guided further in our view of the effectiveness of its current provisions by the Commission's findings on the costs and benefits of the scheme.

Assessing the performance of the NAR and its provisions involves clarifying the objective of the NAR, and identifying the full range of the economic costs and benefits of its application, and comparing that to alternative options, as identified in the scope of the inquiry.

The Commission's report says that, in an ideal world, addressing the impact of the NAR would be greatly assisted by undertaking a 'rigorous cost-benefit analysis'. There are few opportunities to address threshold questions such as this in such detail as can occur in a Productivity Commission inquiry.

It is therefore significant that the Commission has found it difficult to perform an assessment of the costs and benefits of the scheme. In a number of areas the Productivity Commission has examined the costs and benefits from a theoretical perspective due to the difficulties in empirically assessing costs and benefits.

We recommend that the commission should make a formal finding in its final report on the difficulty it has faced conducting a rigorous cost-benefit analysis and the outcome of its assessment of the costs and benefits of the NAR, including its assessment (if it remains the case) that "it has not been

possible to quantify the economic impacts of the regime or its effect on economic growth and productivity" (p. 215).

Saying so in a key finding in the final report would be a constructive contribution to national policy debate as it would establish that there is uncertainty about the impact of the scheme on the Australian economy. Furthermore, it will be helpful for anyone undertaking a similar review in the future (the report recommends another review in ten years time) if the final report can elaborate on the difficulties encountered by the review team in assessing the costs and benefits of the regime.

Such a finding should lead to care and caution being exercised by policy makers in this difficult area of regulation lest there be unintended negative consequences for investment and growth from getting settings wrong, as was canvassed at the time of the original Hilmer Committee reforms.

Notwithstanding some of the difficulties faced by the Commission in its review, in our view the discussion of the costs in the draft report could be further developed.

Item No. 4 of the terms of reference for the review requires the commission to "provide advice on ways to improve processes and decisions for facilitating third party access to essential infrastructure".

We would like to see consideration given to adding explicit findings and recommendations against terms of reference Item No. 4 in the final report, in particular in relation to these two areas listed as sub-points:

- "measures to improve flexibility and reduce complexity, costs and time for all parties" – by undertaking further empirical investigation of the costs associated with the NAR and identifying specific recommendations to reduce those costs for participants, particularly given the uncertainty in the review's findings about the benefits of the scheme.
- "'greenfield' infrastructure projects and private sector infrastructure provision" - by recommending ways to improve certainty around the application of access regulation to greenfield infrastructure projects, as this is a type of investment activity that is both critically important to economic growth and productivity and can be substantially harmed by uncertainty around the threat of regulated access and the risk of regulatory failure. The draft report finds that ineligibility provisions are not being used, and acknowledges that public exposure of the project may be one reason for that. This is an area where more direction would be useful.

Chapter 7 includes some discussion about the considerable costs to participants. Further assessment of ways to reduce costs associated with the regime, including the costs of administration and compliance, is warranted. The final report should make recommendations on ways to reduce costs incurred by participants in the scheme, whether as infrastructure access providers, seekers or program administrators.

For instance, the commission could assess the distribution of costs by individual case to identify why some cases are more costly than others. Table 4.1 provides details on the length of time associated with a number of historical cases under the regime. Ideally this might also include an estimate and supporting analysis of the total costs incurred by the participants in each of these cases as a basis for making more detailed findings about the drivers of costs.

The 'uneconomical to develop another facility' test: Switching from the private profitability test to the natural monopoly test

The commission has proposed that the test for whether a facility is 'uneconomical to duplicate' under criterion (b) should be a natural monopoly test rather than the current 'private profitability' test.

Subsection 44G(2) of the Competition and Consumer Act 2010 outlines the criteria that must be met for a service to be declared. Criterion (b) states:

> "(b) that it would be uneconomical for anyone to develop another facility to provide the service"

As noted in the Draft Report, there are three tests that can be used to apply criterion (b), a natural monopoly test, a net social benefit test or a private profitability test (see page 161).

We agree with the commission's assessment that the social benefit test is difficult to apply and that the preferred test should be one of the natural monopoly test (in the form proposed by the commission) or the private profitability test, which is the 'incumbent' test following the ruling in the Federal and High Courts on the Pilbara Rail case (2010).

In commenting on the commission's finding in support of the natural monopoly test the BCA starts from the position that the NAR should continue to be used sparingly, consistent with the original intent and design of the regime, and the benefits must exceed the costs. In our view the criteria being used to determine whether or not a service can be declared should be narrow, rather than broad.

The commission's report includes a discussion about the risks of false positive and false negative findings. Our view is while we should aim to avoid all wrong decisions, we should err on the side of avoiding 'false positives' when applying the test under criterion (b). That is, avoiding wrong decisions that lead to access regulation being applied when it should not be, due to the potentially significant harmful long term effects on investment.

An important additional consideration for this view is that competition between service providers encourages innovation and the application of new technologies in the development and use of infrastructure that can contribute towards lifting productivity and Australia's competitiveness.

We also note and support Draft Finding 3.1 in the commission's report and consider this to be an important initial finding against which to judge the pros and cons of the tests being considered for criterion (b):

> In markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service), allowing competition between providers will generally be preferable to access regulation because regulation in such markets could reduce welfare.
>
> Access regulation is most likely to provide net benefits to the community where there is monopoly provision of infrastructure services.

We also contend, as we said in our original submission, that there is a benefit to the operation of business in terms of certainty, in knowing which of these criteria will be utilised, and that 'chopping and changing' of the rules generally should be avoided. Consequently, considering changing the test in current use should only occur where there is a clear benefit from doing so. This is especially relevant when the change in the test might lead to greater application of access regulation than less, as it may have a negative and retrospective effect on investment decisions recently undertaken.

As the draft report shows, there are pros and cons associated with the natural monopoly test and the private profitability test when assessing which best achieves the aims of the regime. It is also acknowledged that there are different views among experts and within the business community on which test should be preferred. This demonstrates that there is not a clear cut case in favour of either test.

While we recognise the lengths the commission has taken to assess 'the efficiency and practical consequences of the private profitability test and the natural monopoly test'[1] we are of the view that elements of the analysis should be strengthened ahead of the final report and that a stronger case needs to be made to change to a natural monopoly test.

The analysis we are seeking would address an apparent inconsistency between, on the one hand, the aversion to risks associated with the incorrect application of regulation that seems to inform Draft Finding 3.1 and, on the other, the aversion to risks associated with the loss of economic efficiency that seems to inform the preference for applying the natural monopoly test in Draft

[1] Productivity Commission, National Access Regime, Draft Report, May 2013 p. 20

Finding 8.1. A clearer reconciliation between Draft Finding 3.1 and Recommendation 8.1 would be helpful in the final report.

Secondly, the discussion in the draft report around practicality of the two tests appears to rest largely on claims in submissions and on a theoretical analysis, rather than any empirical assessments of whether or not each test can be easily applied. The commission's conclusion is that 'both tests are challenging to apply' but that 'a private profitability test would be particularly difficult to apply' is not supported with clear empirical evidence in the report.

If the commission has evidence to support this finding on practicality then it should publish it in the report. If not, then our suggestion is that the commission should consider undertaking its own practical testing of each test to contribute to the evidence base on 'practicality' and to further inform its position. Publishing this information would also help to inform and settle the wider debate around the merits of the two tests.

This evidence is especially warranted given practicality is an important factor driving the commission's concerns about the potential for false negative outcomes.

Taking all these factors into account, there is a need for a stronger assessment of the two possible tests under criterion (b), and for a stronger case to be made before arguing for a shift from the current private profitability test to a natural monopoly test including by:

- reconciling the commission's Draft Finding 3.1 that "In markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service), allowing competition between providers will generally be preferable to access regulation …" and the arguments for the commission's preference for a natural monopoly test to replace a private profitability test in Chapter 5 and in Recommendation 8.1
- the commission undertaking its own empirical testing of the practicability of the natural monopoly test and the private profitability test to inform its final assessment about the workability of each test.

Regulatory power to direct extensions and expansions of facilities

The draft report makes two key recommendations in relation to the ACCC's powers for facilities expansion. Draft Recommendation 8.7 says that:

> "The Australian Government should amend subsection 44V(2) of the Competition and Consumer Act 2010 (Cwlth) to confirm the prevailing interpretation by the Australian Competition Tribunal that, when arbitrating an access dispute, the Australian Competition and Consumer Commission can require a service provider to expand the capacity of its facility (in addition to being able to require a geographical extension)."

Draft Recommendation 8.8 says that:

> "As soon as practicable, the Australian Competition and Consumer Commission (ACCC) should develop and publish guidelines on how its power to direct facility extensions (and expansions) would be exercised in practice. The guidelines should be developed by the ACCC using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation."

There are significant costs and risks associated with compelling facilities to expand the capacity of their facilities as the commission acknowledges on page 139 and elsewhere in the report (as do many submissions to the review):

> "Private negotiation is generally preferable to regulated extension (or expansion), particularly because of the practical difficulties of directing investments (including those arising from information asymmetry)."

The strong preference of BCA members in situations where infrastructure is at capacity is for direct negotiations that would result in workable commercial arrangements based on user pays funding for the expansion of commercial infrastructure.

Formalising powers to compel a business to expand their facilities, whether simply confirming the existing interpretation or otherwise, will need to be properly assessed for both practicality and the potentially significantly harmful impacts on investment and economic efficiency in the long run.

The threat of compelling a business to expand their facilities is potentially particularly harmful to greenfield investments and highlights the risks of the modern day application of the NRA drifting from the original intent to improve the economic efficiency of infrastructure services through the granting of access.

We agree with the commission's view that there should ultimately be clarity in the Act about whether the ACCC should have the power to direct expansions of facilities and that the preparation of guidelines around how those powers will be used will be useful. To the greatest extent possible, businesses want certainty around the rules that they are bound by and around the likely outcomes associated with these rules. Greater certainty makes it easier for businesses to operate and enable them to make investments and decisions with more confidence.

We recommend however the final report should make clear that direct negotiation is greatly preferred to regulation, not 'generally preferred' as stated on page 139, to properly reflect the significant costs and risks from directing investment.

We also recommend that powers to expand the capacity of facilities should not be included in the Act without a thorough and rigorous supporting cost-benefit analysis that properly weighs up the risks involved and demonstrates a clear net economic benefit.

Guidelines for how the ACCC should apply any facilities extension (or expansion) powers as recommended by the Commission would be helpful, however, as the body exercising the powers the ACCC should not be solely tasked with developing the guidelines. Rather:

- the commission should set out its own set of guiding principles for the use of facilities extension (or expansion) powers in its final report, including setting a clear preference for negotiated outcomes and incentives for achieving that outcome
- an independent advisory panel should be established to make recommendations on the development of any guidelines, made up of access regulation experts and business participants.

The Competition and Infrastructure Reform Agreement

The BCA endorses the commission's analysis of the CIRA in Chapter 10, in particular the recommendations to refresh the application of competitive neutrality policy. The BCA urges all governments to implement these recommendations promptly, ideally within the next twelve months.

In response to Information Request 10.1, the BCA retains the view in our original submission that there is a case for governments to pursue a renewed agenda for upgrading infrastructure regulation to meet the future needs of the Australian economy, whether that is in the form of a new CIRA or some other intergovernmental agreement. A new agreement should include reforms that will promote new and efficient investment in infrastructure, including commitments towards:

- nationally consistent third-party access regulation and a consolidation and a lift in the consistency, capability and performance of Australia's economic regulators
- a renewed commitment to competitive neutrality to ensure that new and existing government-owned infrastructure businesses are operating efficiently and fairly, especially new GBEs
- a new timetable for privatising government-owned infrastructure businesses to capture efficiencies from private ownership and unlock public funds
- reforms to pricing infrastructure that move towards full recovery of the efficient costs of infrastructure provision, including an adequate risk-adjusted return on investment, and grow infrastructure markets.

We propose that the commission consider turning Draft Finding 10.2 into a recommendation to encourage governments to take steps to put in place appropriate access arrangements to facilitate

more privatisation of government owned infrastructure businesses. For example in the energy and water sectors, Infrastructure Australia in its 2013 report to COAG, has identified up to $60 billion of water assets and up to $60 billion electricity network and generation assets that could be transferred to the private sector, enabling efficiencies in operation and the release of funds for new infrastructure investment. The adequacy of regulatory frameworks is a potential barrier to these sales occurring.

BCA position on Draft Recommendations

Draft Recommendation 8.3

The Australian Government should amend paragraphs 44G(2)(a) and 44H(4)(a) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (a) becomes a comparison of competition with and without access on reasonable terms and conditions through declaration.

- The BCA supports this recommendation.

Draft Recommendation 8.1

The Australian Government should amend paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (b) is met where total market demand could be met at least cost by the facility. Total market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. The assessment of costs under criterion (b) should include an estimate of the costs associated with additional maintenance and reduced operational flexibility imposed on the infrastructure service provider from coordinating multiple users of its facility.

- The final report in our view should strengthen the assessment of the two possible tests under criterion (b), and provide a stronger case before arguing for a shift to a natural monopoly test including by:
  - reconciling the commission's Draft Finding 3.1 that "In markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service), allowing competition between providers will generally be preferable to access regulation …" and the arguments for the commission's preference for a natural monopoly test to replace a private profitability test in Chapter 5 and in Recommendation 8.1
  - undertaking its own empirical testing of the practicability of the natural monopoly test and the private profitability test to inform its final assessment about the workability of each test.

Draft Recommendation 8.2

If criterion (b) continues to be applied as a private profitability test, the Australian Government should amend the definition of 'anyone' in paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) to exclude the incumbent service provider.

- The BCA has no comment.

Draft Recommendation 8.4

The Australian Government should amend paragraphs 44G(2)(f) and 44H(4)(f) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (f) requires that declaration promotes the public interest. As part of their assessment of the public interest, decision makers should be required to have regard to the effect of declaration on investment in markets for infrastructure services and dependent markets, and compliance and administrative costs.

- The BCA supports this recommendation.

Draft Recommendation 8.5

The Australian Government should amend Part IIIA of the Competition and Consumer Act 2010 (Cwlth) to:

- remove paragraphs 44G(2)(e) and 44H(4)(e)
- introduce a threshold clause stating that a service cannot be declared if it is subject to a certified access regime
- include provision for the Commonwealth Minister to revoke the certification of an access regime, based on advice from the National Competition Council (NCC), if there has been a substantial modification to the certified regime or the principles in clause 6 of the Competition Principles Agreement (CPA), such that the regime no longer meets the principles in clause 6 of the CPA
- enable infrastructure service providers, access seekers and the relevant state or territory government to apply to the NCC to make a recommendation to the Commonwealth Minister for the revocation of certification. The NCC should also be able to initiate the revocation of certification (consistent with the current arrangements for revocation of declaration and ineligibility decisions).

The protection from declaration offered by certification should apply until the expiration of the certification, unless the certification is revoked by the Commonwealth Minister.

▶ The BCA has no comment.

Draft Recommendation 8.6

If the commission's recommendations to amend the declaration criteria are implemented, the Council of Australian Governments should consider amending the Competition Principles Agreement to align the principles in clause 6(3) with Part IIIA of the Competition and Consumer Act 2010 (Cwlth).

▶ The BCA supports this recommendation.

Draft Recommendation 8.7

The Australian Government should amend subsection 44V(2) of the Competition and Consumer Act 2010 (Cwlth) to confirm the prevailing interpretation by the Australian Competition Tribunal that, when arbitrating an access dispute, the Australian Competition and Consumer Commission (ACCC) can require a service provider to expand the capacity of its facility (in addition to being able to require a geographical extension).

▶ We agree that there should be clarity in the Act about whether the ACCC should have the power to direct expansions of facilities, with any change to the Act subject to a rigorous and transparent cost-benefit analysis. We would prefer the final report to say that direct negotiation is greatly preferred to regulation to better reflect the significant costs and risks from directing investment.

Draft Recommendation 8.8

As soon as practicable, the Australian Competition and Consumer Commission (ACCC) should develop and publish guidelines on how its power to direct facility extensions (and expansions) would be exercised in practice. The guidelines should be developed by the ACCC using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation.

▶ Guidelines would be helpful, however, as the body exercising the powers the ACCC should not be solely tasked with developing the guidelines. Rather:

  – the Commission should set out its own set of guiding principles for the use of facilities extension (or expansion) powers in its final report, including setting a clear preference for negotiated outcomes and incentives for achieving that outcome

- an independent advisory panel should be established to make recommendations on the development of any guidelines, made up of access regulation experts and business participants.

Draft Recommendation 9.1

If the designated Minister does not publish a decision on a declaration recommendation within the 60 day time limit, this should be deemed as acceptance of the National Competition Council's recommendation.

▶ The BCA has no comment.

Draft Recommendation 10.1

The Australian, state and territory governments should regularly review their competitive neutrality policies to ensure that they remain relevant and reflect contemporary practice. Specific matters that should be considered include:

- clearer guidelines on the application of competitive neutrality during the start-up stages of newly established government business enterprises that are or will be engaged in significant business activities
- whether processes for handling competitive neutrality complaints are identifiable, independent and accessible
- how governments respond to the findings of competitive neutrality complaint investigations.

To strengthen accountability for competitive neutrality outcomes, the Heads of Treasuries should set a target for producing their annual competitive neutrality matrix report within six months of the end of each financial year.

▶ The BCA supports this recommendation and adds that in our view governments should ideally review their competitive neutrality policies within the next 12 months.

Draft Recommendation 10.2

The Council of Australian Governments should commission a further independent review of the NAR no later than 10 years after the Australian Government has formally responded to the final recommendations of this inquiry.

▶ The BCA supports this recommendation.

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