
AusCID Submission to the Productivity Commission Review of National Competition Policy

The unfinished business.

The Australian Council for Infrastructure Development

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Executive Summary

This submission, on behalf of infrastructure investors, operators, financiers and maintenance providers, addresses National Competition Policy (NCP) as it has impacted on the infrastructure sector and, prospectively, how it should impact.

In AusCID's view the quality of infrastructure service provision in Australia is much better today than it would have been if NCP had not been pursued. Further, the quality of infrastructure service outcomes seems to be relatively strongly correlated to the extent of reform undertaken. Even so, NCP execution has at times lacked focus, with elements of contradiction and fragmentation.

In a globalised world, there will always be unfinished business in competition policy. For Australia to maintain, let alone, improve its competitive position through sustainable infrastructure service delivery, AusCID advocates ongoing policy reform in the following areas:

- **Taxation** – The taxation system remains biased against long-term investments which are “lumpy” and slow to achieve commercial critical mass, as are many infrastructure investments. Competitive neutrality has not been comprehensively achieved in utility and public transport sectors where there are private and government-owned service providers, largely due to differences in taxation treatment. Imperfections in the financial relationship between the Commonwealth, states and territories impact on private investment in infrastructure provision, a growing proportion of the sector.
- **Regulation** – Policy and administration of regulation require more effective separation with better opportunity for full merit reviews. Regulatory policy needs to focus more on long-term economic efficiency with a better balance between current prices and future investment. Proper resourcing of regulatory agencies is required along with the cost of regulation being distributed among all beneficiaries.
- **Energy Markets** – Private investors require additional assurances about the functional separation of the Australian Energy Regulator from the ACCC. Full commitment by all state governments to the reform agenda, including full retail contestability without price caps. Investor appetite for new baseload generation capacity is likely to remain uncertain in the absence of a national bipartisan Greenhouse strategy.
- **Land Transport** – Early support from the states and territories for the AusLink strategy is a precondition for improved competition in the freight sector. Road and rail access pricing (including fuel excise issues) needs further development to achieve optimal modal share of the long-haul freight task.
- **Urban Infrastructure** – Private sector penetration of urban public transport and water markets requires further facilitation in the interest of secure supply and better services. This will need to be backed by more realistic pricing policies in the case of scarce water resources.

Introduction

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

The Council formed in 1993 and currently has 91 members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of its membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

The Productivity Commission's Review of National Competition Policy presents itself as an excellent opportunity to reflect on the success of over a decade of micro economic policy reform and chart a future course for this important policy area which is sometime neglected, and often misunderstood in public debate.

The Commission has identified four key elements of National Competition Policy (NCP) that emerged out of the CoAG process of 1995¹:

- Extension of Part IV of the *Trade Practices Act 1974* to professional and occupational services and government business enterprises (GBEs)
- Structural reforms of GBEs exposing them to what might be called "level playing field" competition in relation to their financial and taxation positions and the establishment of separate regulator bodies
- The establishment of the National Access Regime
- Review of legislation that restricted competition

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

In this submission, we treat NCP more as an underlying policy rationale than a set of specific actions. The definitional issue is not an important one and a broad scope enables the best treatment of the central issue – what should future policy look like. Our commentary is generally restricted to the infrastructure sector.

Over the past few years there has been a range of inquiries conducted into areas of interest to AusCID's membership. Some of these have been conducted by the Commission (such as the reviews of the Prices Surveillance Act, the National Access Regime, Price Regulation of Airport Services and the current review of Gas Access Regime). Other important reviews at the Commonwealth level have been the CoAG review of Energy Policy (the Parer inquiry), the review of the Mandatory Renewable Energy Target

¹ Productivity Commission (2004) *Review of National Competition Policy – Issues Paper*, Melbourne April, p2.

and the processes leading up to the recent publication of the White Paper on Land Transport (Auslink).

The outcome of these reviews, and a number of others, has been to refine and reinforce NCP in the light of changing market and institutional circumstances. Whilst AusCID believes there is still significant policy work to be done, it is our unqualified view that the quality of infrastructure service provision in Australia is much better today than it would have been if NCP had not been pursued. Further, the quality of infrastructure outcomes seems to be relatively strongly correlated to the extent of reform that has occurred.

The Commission is well aware of AusCID's views on a range of regulatory issues and our submissions to the inquiries mentioned above, and those of our members, are on the public record. As such, and consistent with our understanding of how the Commission is seeking to approach this review, we do not intend to re-run those arguments in relation although if the Commission wishes an update on any specific questions, we would be only too happy to answer any questions.

Whilst NCP has delivered significant benefits, it has at times lacked focus, with elements of contradiction and fragmentation. This has undermined public support for the underlying policy purpose. This has been exacerbated by a lack of the political commitment, and often understanding, needed when reforms involve short term economic impacts on specific interest groups that often have a degree of local political power.

Much of the reform process has been directed at bringing competition to sectors which previously provided services to consumers and the tradeable sectors of the economy essentially on an administrative basis. Competition is a dynamic process. It enables our economy to adapt to changing resource availability, technologies and consumer tastes. Moreover, the nature of competition itself responds and changes to these fundamental economic forces over time.

We must however not pursue competition for competition's sake. It is the balancing of the costs and benefits of competition that is the purpose of competition policy and this policy must adapt and change over time. In a sense, there will always be unfinished business in competition policy. If Australia ever reaches the point where competition policy is considered unimportant, we will have a very serious economic problem indeed.

The remainder of this submission is divided into two sections. The next section looks at a range of specific issues we consider to be some of the unfinished business of the reform process. The final section offers some thoughts on how the process can be taken forward to lock in the gains to date and unlock future opportunities.

The unfinished business

Taxation

It might be asked why tax is an important issue in a review of NCP. The answer is simple. Taxation, in part, determines both the cash flow and equity returns to investors in infrastructure. If infrastructure investment is inadequate then the competitive conditions in downstream markets are impeded, especially if access rights to limited capacity rest in the hands of incumbents. Competition in the provision of infrastructure and breaking the effective monopoly of government supply are vital.

If the administration of the tax law is at cross purposes to other areas of government policy the result is increased uncertainty in the minds of investors as to the overall stance of government policy. To ensure that this is not the case in the infrastructure sector it is important to ensure:

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- The tax system should incentivise efficient infrastructure investment that leads to improved infrastructure outcomes and sustained and increased competition in other markets. It appears that the current approach proposed for Division 250 may, for example, deter investment in road infrastructure required to be funded by shadow tolls.
 - The taxation system should not cause distortions in contestable markets where both government and privately owned firms operate. It seems likely, based on the current exposure draft, the proposed amendments to Division 250 will impact on the National Electricity Market by creating a distinction between energy sold to state government owned retailers and privately owned retailers.

Regulation

AusCID has supported the approach pursued by the Commission and governments in removing regulation of the infrastructure sector. As to the future of NCP we believe it would be appropriate to consider some high level principles:

- The decision to regulate, and the advice to government on regulatory policy, should be provided by organisations other than regulators. This principle is embedded in the national access regime and has been generally adopted by the Commonwealth but its application is less complete at the state level.
- The focus of regulatory policy must be delivery of long run economic efficiency in the allocative, productive and dynamic efficiency sense. Distribution should not generally be the focus of regulatory policy and in particular, holding down prices for their own sake should not be an objective of regulatory policy.
- Full merit reviews by independent bodies must be available in relation to all decisions made by regulators.
- The financial costs of regulation should be borne by the beneficiaries and in particular, funding arrangements should not discourage regulated firms from pursuing their legitimate interests (such as has been the case in Western Australia where Epic Energy ultimately had to foot the regulators costs associated with Epic's successful appeal)
- Governments should ensure that regulatory agencies are properly resourced both fiscally and in respect to the quality of their Commissioners and senior officers. It is worrying that very few Commissioners or senior staff have any operational commercial experience.

Energy market reform

AusCID supports and has been an active participant in the recent rounds of energy market reform. The commitment of CoAG to the development of a truly National Energy Market is supported and encouraged. There are real prospects that over time the Australian Energy Markets Commission (AEMC) and the Australian Energy Regulator (AER) could emerge as a pair of credible institutions to manage the Australian energy market and deal with many of the market design and regulatory issues that have been of concern over recent years.

However, there is a range of issues which still need to be addressed:

- The right of full merit based appeals of decisions of the regulatory agencies to the Australian Competition Tribunal.

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- Satisfying market participants that the AER will be independent from the ACCC other than for administrative purposes. Despite the intention of CoAG that the AER would be largely independent of the ACCC in its regulatory activities, recent statements by the Chairman of the ACCC seem to indicate otherwise².
 - Full commitment to the reform agenda by the relevant state governments and in particular full retail contestability and ensuring that the market conduct and treatment of participants does not depend on whether they are government or privately owned. In a recent survey of market participants by PricewaterhouseCoopers³, 57% of respondents believed that to deliver a truly efficient national energy market full retail contestability needed to be adopted within all jurisdictions within 1-2 years. The remainder of respondents this was essential with 2-3 years. It is respondents expectations that are most concerning – 58% believe the necessary reforms will take between 5 to 10 years and 14% believe they will never occur.
 - The delivery of a national bipartisan approach to greenhouse strategy. The current policy differences at the federal level and a range of uncoordinated state-based policies will not in the long run provide the consistency and certainty to sustain the levels of investment needed in all forms of generation/production, transmission and transmission.

Land transport policy

AusCID has welcomed the recent land transport White Paper from the Commonwealth. Improving the nation's land transport infrastructure can only enhance competition in markets for freight services. However a number of issues remain unresolved:

- The commitment of the States to the planning and funding of the infrastructure program contained in the White Paper
- The length of time it will take to deliver major components of the infrastructure program (such as the duplication of the Hume and Pacific Highways) which could be significantly reduced if state and federal governments were prepared to adopt a more rational approach to debt funding infrastructure.
- It is imperative that the debate on the relative prices of access to rail and road infrastructure move from its current position of being largely about the incidence of taxation and the allocation of scarce budgetary resources. What is needed is a more rational commercial basis that reflects both cost and quality and the relative commercial advantages of the respective modes and downstream service providers. The prime objective must not be to ensure that prices are held down but rather they adjust in an orderly way to provide a sustainable basis for the provision of services into the future. If rail access charges continue to be constrained in the market by uneconomically low road user prices, very little private sector funding will be attracted to the rail infrastructure and intermodal competition will not properly develop.

² In the *Business Review Weekly* of June 3-9 (p56) the ACCC Chairman said "A single regulator is being established in the ACCC".

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

Urban infrastructure services

The vast majority of Australians live in five major cities and their associated satellites. It seems likely that the relentless pressure on urban services will continue into the future and our cities will continue to grow.

AusCID believes that it is possible to bring increased private sector involvement to the provision of urban services provided a number of preconditions are met:

- Some services are better provided by Governments. Governments must be prepared to borrow to invest in long term public infrastructure that generates economic and social returns – if the stock of public assets is inadequate then the private sector will struggle to provide complementary assets. The public sector must move from its current approach which is best characterised as “fix on fail” to one more akin to “plan and provide”.
- The tax issues discussed above must be resolved.
- The transaction costs associated with public private partnerships must be reduced and bidding and appraisal processes simplified. This will enable the PPP market to develop and will also increasingly bring private capital and expertise to areas of social infrastructure such as hospitals and schools.
- Governments must develop more efficient procurement processes by addressing better long-term strategic planning, whole-of-asset-life maintenance budgeting and more cost-effective project budgeting. Drip-feeding capital to highly beneficial projects is unwarranted if there is capacity to borrow prudently and accelerate their completion.
- Many urban public transport systems in Australia exemplify the consequences of lack of competition leading to inefficient allocation of resources, poor work practices and the absence of a service ethos.
- Water is different from most other regulated industries in one important regard - it involves a factor input that is scarce in the true economic sense: water itself. In every other industry, additional services can be supplied by the regulated firm via further capital and operating costs or increased productive efficiency. It is plausible that in the medium term, the volume of water input may fall, as climate change evidence mounts. As a paper by the Centre for International Economics⁴ correctly identifies, the current price of water in Sydney does not in anyway reflect the scarcity value of the primary resource and regulatory arrangements seem to be making things worse.

⁴ Centre for International Economics (2004) *Water price restructuring and the role of Sydney's wholesale water price*, prepared for the Independent Pricing and Regulatory Tribunal of NSW, Sydney, April.

The future shape of competition policy

National Competition Policy has a bad brand in parts of the community. The future successful prosecution of a reform agenda of this type will require political and community support. We would therefore urge the Commission to consider why a policy that has delivered such great benefits has been so unpopular. We offer several suggestions.

The issues associated with infrastructure have largely gone uncontested in the public domain. Whilst there has been significant debate in professional circles, the underlying policy rational is unchallenged and indeed welcomed.

The major gains from NCP came with decisions taken by governments in the early years. Yet the bulk of the reform work was contained in the legislative review process. This review process lacked focus – everything was to be examined, otherwise states would lose their competition payments. The application of the consultants “80-20 rule” in seeking 80% of the benefits for 20% of the effort could have led to greater community acceptance. Also, the wide ranging nature of the review process enabled governments to avoid (or at least delay) the issues where there were strong vested interests.

Future policy must be more focused. A defined program must be established and agreed by CoAG that is directed to ensuring that important national markets continue to develop and that government policy supports those developments. Within the infrastructure sector, AusCID believes that the following goals are important and achievable:

- Development of a national energy market with full retail contestability in place and the sale of the remaining state government owned electricity companies underway by 30 June 2007.
- Ensuring full merit reviews for all decision taken by regulators and ensuring the separation of regulatory policy from regulatory decision making.
- Proper resourcing, in monetary and personnel terms, of our regulatory institutions.
- An acceptance by Government of their obligation to fund public goods including by way of debt financing.
- Resolution of infrastructure tax issues.
- Uniform national pricing frameworks for national transport networks including proper recognition of public good elements.
- Reappraisal of the approach to regulation in low contestability sectors where investment needs are becoming critical.