

**Competition Policy Review, Draft Report, September 2014**

The Department of Infrastructure and Regional Development (the Department) has prepared this submission on the Competition Policy Review Draft Report in order to provide views and comments on a number of issues raised in the Draft Report of relevance to the portfolio. As the Draft Report is wide-ranging in the matters it covers, the Department has limited its comments to those issues where its views may be of particular value to the Panel as it develops its final report and recommendations to the Australian Government.

## **Land transport infrastructure**

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### **Road Transport (Draft Recommendation 3)**

The Department of Infrastructure and Regional Development (the Department) supports reform in road investment, management and pricing and provision as part of broader approach to creating an integrated land transport (and transport infrastructure) market.

The Department is of the view that road investment and pricing reform is the next area of major economic reform for Australia, reflected by activities already included in the current reform agenda. Over recent years, a number of reviews have recognised the need for reform and have proposed possible road-pricing models. There has been significant work done by the Commonwealth and state and territories to this end. However, as noted in the Draft Report, much greater progress in full market reform needs to be made. The Department shares the Panel's view that road pricing reform holds great potential for efficiency improvements that in turn will lead to productivity benefits in the wider economy.

The Productivity Commission's recent inquiry into Public Infrastructure examined the need for road user charging reform in detail. The Productivity Commission recommended establishing user charging as the default option to fund road infrastructure and considering alternative road governance models, including commercially-oriented road fund models. As noted previously by the Productivity Commission (2006):

*...such a fund requires a significant devolution of responsibility and decision-making away from direct government control to an autonomous agency.<sup>1</sup>*

In line with the Draft Report, the Department is of the view that agreeing a model for implementation of a commercially-oriented road fund (or funds) is a priority task on the pathway towards user charging and reducing direct budget funding (excise and grants) for road authorities— at all levels of government.

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<sup>1</sup> Productivity Commission 2006, *Road and Rail Freight Infrastructure Pricing*, Report no.41, Canberra, December, p.272

The Productivity Commission has most recently observed that:

*The limitations of not having a clear price signal for road use have been recognised for many years, but it has proved very challenging to address this. The greatest progress has been made with charging heavy vehicles, but even there the issue is not addressed effectively, and further reform has been under development<sup>2</sup>.*

The current context within which our roads are governed, managed and funded across a number of jurisdictions (at both state/territory and local government levels) has complicated progress towards reform in this area. We are of the view that while initial steps have been made to investigate how road pricing could be designed and introduced—particularly for heavy vehicles—further work should be done to move towards full market reform. It is important that a road investment market is created which captures all road uses.

As the Panel noted, progress toward road pricing for heavy vehicles has been made. Current efforts are primarily focussed on developing and implementing heavy vehicle charging demonstration trial projects. The recent Heavy Vehicle Charging and Investment (HVCI) project (which concluded on 30 June 2014) found that to be effective, road pricing reform should be supported by improvements to the way roads are planned, built and maintained. The Transport and Infrastructure Council has recently agreed that the next phase of heavy vehicle road reform will require road agencies to become more customer-focused in how they provide roads—resulting in improved trust and transparency with industry and laying a solid platform for future reforms, such as pricing.

In the long term, the Department sees a need for policy changes in relation to heavy vehicles which go beyond price signals—such as integrated charging, funding and investment reforms—which may address some of the limitations of work to date on heavy vehicle charging highlighted by the Panel.

The creation of a sub market for heavy vehicles will not, however, deliver the widest possible economic benefits. Cooperation from all levels of government will be needed to progress full market reform. It is also important industry and the community are part of the debate and discussion on these reforms. It will be crucial to demonstrate to the community that road pricing is about reconfiguring current road revenues and expenditure in such a way that the surface transport market (in particular road and rail) is a competitive market resulting in the best prices and outcomes for the community—rather than an additional tax imposition. As noted by the Review Panel, the introduction of cost-reflective road pricing must be seen to reduce indirect taxes and charges on road users—this will be fundamental to strengthening competition policy reform in infrastructure.

The Panel may wish to further acknowledge in its final report the long term nature of reforms to road pricing, noting the many complex issues that need to be worked through with jurisdictions and the community before user charging could be rolled out on the scale proposed by the Panel. Consideration could also be given to interim measures such as direct charging through tolls and other trials which provide improved investment signals as well as improved access for road users. Reform along these lines has been considered in the context of the current Infrastructure Investment Programme, such as heavy vehicle charging for the Perth Freight Link announced in the 2014-15 Budget. Reforms in this area should also be considered in the context of the Taxation White

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<sup>2</sup> Productivity Commission 2014, *Public Infrastructure*, Inquiry Report No. 71, Canberra, p.145

Paper process given the implications for reconfiguration of Commonwealth/state funding arrangements for land transport infrastructure that would need to complement the user pays principle.

### **Multi-modal transport**

In moving toward a more efficient, integrated multi-modal transport network (as opposed to traditional mode-specific approaches), there needs to be a new approach to how modes interact. For example, in considering user-charging regimes for road transport, thought must be given by states and territories to setting the right pricing signals for public transport. Currently, less than a third of public transport operational costs are recovered through fares—although simply increasing fares could further disadvantage public transport services in situations where using a private vehicle is cheaper and there are not comparable road-user costs. Such a low rate of cost-recovery in public transport has implications for the viability of private operators, service standards, maintenance and future capital investments.

In consideration of these issues, the Panel may wish to expand its discussion on transport infrastructure and to acknowledge how competition principles could be applied within an integrated transport market. Such an approach could effectively increase the role of the private sector in transport and infrastructure investment, operations and maintenance.

### **Rail freight**

The Department notes the Panel's generally positive observations on the pace and outcomes of major rail reforms spanning the last two decades which have increased private sector involvement, better met the needs of customers and provided long term employment in the rail sector (Draft Report, Section 9.2).

In recent years, governments have fundamentally changed their approach to planning and investment in the freight network; from looking at each mode in isolation, to a multi-modal and integrated freight network. As a mode, an efficient and effective rail system needs to play an increasingly significant role in Australia's freight task and reduce the relative costs of bulk freight over Australia's long distances.

The largest rail freight flows in Australia are bulk iron ore and coal. Rail also accounts for the majority of inter-capital freight movements on the East-West corridor. However, the percentage of general freight travelling by rail on the east coast North-South corridor remains low and has not achieved strong growth, and the use of 'port shuttle' type arrangements from ports to inland rail hubs remains limited. With the forecast increase in the freight task, there will be a commensurate increase in the number of trucks on the roads in Australia's more heavily populated eastern states, to meet forecast growth in the absence of an efficient rail system. This will impact national productivity. Accordingly, more needs to be done to increase, or at the very least maintain, the market share of general freight carried by rail.

Governments, and the Australian Rail Track Corporation (ARTC), have invested in infrastructure to improve the quality and reliability of the interstate rail network to address capacity and curfew restrictions through metropolitan areas. These initiatives will further address the capacity of rail to compete on transit times, price and service reliability. It is also important that competition policy

maximises investment incentives and competition within the rail sector and between rail and other modes of transport.

In particular, there is potential to increase rail's share of the bulk freight task in regional areas. Consistent with the Panel's views, where freight volumes have been too low to support competitive entry on grain rail lines, vertical integration or other changes to the current rail access and ownership model may be preferable as a means to re-establishing the viability of under-utilised rail infrastructure. Realising this potential will require comprehensively understanding the factors driving modal choice, the incentives to maintain and upgrade the rail lines and the impact on access and competition. Vertical integration would not be appropriate on lines where there is above rail competition, such as the interstate network.

In finalising its report, the Panel may wish to consider the ARTC's position as manager of much of Australia's interstate network. ARTC was created in 1997 as a 'one stop shop' to grow interstate rail through improved efficiency and competitiveness. ARTC's objectives include:

- increasing rail's share of the interstate freight market; and
- fostering a commercially viable Australian rail industry, thereby contributing to an efficient national transport system.

ARTC was also created to provide efficient and seamless access to the interstate rail network, which it does through voluntary Australian Competition and Consumer Commission (ACCC) approved access undertakings. Since its creation, ARTC has invested approximately \$4 billion into the interstate network under its control. Freight carried on ARTC networks has gone from 74.6 billion tonnes kilometre in 2008-09 to 101 billion tonnes kilometre in 2013-14.

The Commission of Audit and Productivity Commission have both proposed that ARTC be considered for divestment. The Panel may wish to consider the implications of possible privatisation of ARTC for competition, access arrangements and governance of the rail network, and what if any changes may be required in a privatised environment.

## **Aviation**

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### ***Aviation Cabotage (Draft Report Section 9.2)***

The Department notes the Panel's view that there are likely to be considerable benefits flowing from the removal of air cabotage restrictions on remote and poorly served domestic routes, allowing foreign airlines to carry Australian domestic traffic. There is little to support the Panel's simplistic view. However, the Department considers the current policy of reserving the Australian domestic market for Australian-based airlines ensures domestic airlines all operate on the same level playing field in relation to industrial relations and taxation, as well as under the safety and security oversight of the Australian Government. As such, the Department does not agree with the Panel's views on relaxation of aviation cabotage arrangements, including for specific routes only.

Australia has one of the most open and competitive domestic aviation policies of any major country. The current policy allows any foreign airline interested in competing in the Australian domestic market (subject to Australian safety, security, employment and taxation arrangements) to do so via an Australian-based subsidiary.

The Department also notes that Australia's highly competitive domestic market has resulted in benefits for consumers and the tourism industry but significant losses among Australian airlines in recent times. In this environment, it is unclear whether the relaxation of aviation cabotage would see any overseas airlines choosing to enter the Australian domestic market.

Further, in order to realise the full economic benefit of cabotage (which would require Australia to permit foreign airlines to import their lower cost base to the Australian market), Australia would be largely reliant on the regulatory oversight of foreign governments to ensure the safety of Australian domestic flights. Successive Australian Governments have taken the view that it is important for airlines carrying domestic passengers to be subject to Australia's full regulatory oversight, through a requirement to hold an Australian Air Operator's Certificate. Australia's ability to effectively and independently monitor an overseas based airline is limited, however, the need for local risk assessment—in line with international performance standards, as per Australian systems—is a recognised worldwide strategy to *mitigate* aviation risks. In this regard, the Draft Report's proposal is likely to be seen as winding back some of the safety arrangements applicable to domestic aviation (*see also general points regarding regulation review at page 7 of this submission*), and as a result, increasing risks faced by the travelling public.

#### ***Airports (Draft Report Section 9.2)***

The Department notes the Panel's view that in aviation, price monitoring and a 'light handed' regulatory approach seems to be working well overall, but that a move away from light-handed regulation for individual airports may be required if prices continue to increase as fast as they have been. The Department is of the view, however, that the current regulatory options available within the CCA—such as price surveillance powers under Part VIIA—are sufficient to address individual airports determined to be charging excessive prices in the future.

#### ***National Access Regime (Draft Recommendation 38)***

The Draft Report considers reforms to Part IIIA regulation of third party access to identified bottleneck infrastructure. It also queries what other infrastructure may need to be covered by access regulation in the future. In this regard, the Department notes that the likelihood of capacity constraints at some airports and intermodal terminals in the next decade does have the potential to lead to an increase in access disputes. Terminals approaching maximum capacity may be able to charge prices above optimal levels and reduce competition. The National Access Regime may be called upon more frequently if this situation eventuates.

While plans for new runway and terminal facilities at Brisbane, Melbourne and Perth will address capacity constraints over time, it will be important to have a credible access regime to back up negotiations. The Department believes that in the event commercial negotiations fail to provide acceptable outcomes, the National Access Regime in its current form provides an important backstop to the regulatory system.

#### ***Airservices Australia Charges (Draft Report, Section 9.2)***

The Panel suggests that the pricing structure for services provided by Airservices Australia (Airservices) should be a focus for further reform. Given Airservices' services, including ARFFS, are already delivered under a five year pricing agreement which is negotiated with industry and

subsequently submitted to the ACCC for assessment, in the Department's view there is not a compelling case for further review of current pricing arrangements.

## Shipping

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### *Liner Shipping (Draft Recommendation 4)*

The Department notes the Panel's Draft Recommendation on liner shipping.

Currently, operators of liner shipping services have immunity from key parts of Australian competition legislation under Part X of the *Competition and Consumer Act 2010*.

Two major Australian reviews of Part X during the 1990s, including one by the Productivity Commission in 1999, recommended that Part X be retained. The main reason is that, due to the particular characteristics of the liner shipping industry, coordination between shipping lines in the same trade on sailing schedules and rates is unavoidable in order to secure regular and reliable services at stable freight rates. A requirement to obtain authorisation under Part VII of the Act for agreements on a case-by-case basis would be a costly and lengthy process for shipping companies, with an uncertain outcome. This is unlikely to provide any economic or competition benefit to Australia.

As recognised by the more recent reviews of Part X and by overseas inquiries, changes in the nature of the liner shipping industry over the last two to three decades have dramatically weakened the rationale for competition law exemptions for conference ratemaking agreements. These changes include the growth of slot chartering, vessel sharing, consortia, alliances, mergers, vertical integration into terminals, long-term confidential contracts, and hub and spoke route systems. The US and EU reforms, which stripped shipping conferences of the ability to collude to set rates, have been shown to have had few negative effects. However, they have not been found to have any positive effects in reducing freight rates either. There is evidence that the reforms have been associated with increased market concentration.

The Department considers that while there is an argument in competition policy thinking for the exemption for pricing agreements under Part X to be no longer justified, the benefit of making changes has not been identified. It is important that shippers and shipping companies have certainty and do not face increased transaction and compliance costs through any changed regime. There remains a strong case for continuing an exemption for *operational agreements*. This is in line with the EU approach of removing the block exemption for conferences to set rates while retaining the block exemption for operational co-operation between shipping lines (vessel sharing, co-ordination of routes and schedules).

The Panel's recommended block exemption approach provides a way to achieve this without imposing the significant compliance costs of requiring case-by-case authorisation of individual agreements. It is important then that the block exemption framework be crafted in such a way that it will allow exemption for operational agreements and not impose an undue regulatory burden on the industry, given the operational reality of the liner shipping industry.

### ***Coastal Shipping (Draft Recommendation 5)***

The Department notes the Panel's findings and observations on coastal shipping. A review into coastal shipping regulation is currently underway by the Australian Government, with a view to revising or reversing measures that hinder the competitiveness of Australia's shipping services. The Government invited submissions from industry and other stakeholders earlier this year, which are currently being considered.

## **Comments on other areas of reform**

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### ***Parallel imports (Draft Recommendation 9)***

The Panel may wish to highlight the Government's current review of the *Motor Vehicles Standards Act 1989* - the legislation which sets uniform minimum safety and environmental standards for all road vehicles entering the Australian market, including those that are imported. The Act restricts parallel or other imports of vehicles which are unable to meet these standards. The review is well progressed and is due to conclude by the end of 2014. A copy of the MVSA Review Discussion Paper can be found at [http://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/files/MVSA-Options\\_Discussion\\_Paper.pdf](http://www.infrastructure.gov.au/vehicles/mv_standards_act/files/MVSA-Options_Discussion_Paper.pdf)

### ***Regulation review (Draft Recommendation 11)***

Regulators within the infrastructure portfolio are considering current and proposed regulations to reflect risk and public interest considerations as part of the Government's red tape reduction programme.

The portfolio's regulators must act in the public interest—including safety—which does not always align solely with enhanced competition in the regulated industries. Indeed, substantial productivity losses to the economy can result from regulatory failures, which can have significant impacts for families, communities, businesses, and even at the whole-of-economy level depending upon the scale of the system failure.

The Department, while seeking to minimise regulatory burden, must achieve a balance between productivity and competition gains and the economic cost of death and injury. Harmonising regulations with international standards significantly can reduce or remove adverse effects on competition whilst maintaining the necessary safeguards. This process of harmonisation is being accelerated as part of the Government's deregulation agenda. The Regulatory Impact Assessment process, prescribed by the Office of Best Practice Regulation, also ensures that where standards are necessary, that the regulatory burden is minimised. The Department is of the view that the Panel's final report could benefit from further acknowledgement of the challenges involved in balancing competitiveness policy objectives and the necessary mitigation of risk which are particularly relevant in transport safety and security.

### ***Access and Pricing Regulator Functions (Recommendation 46)***

The Department notes the Panel's Draft Recommendation 46 regarding the establishment of a single national access and pricing regulator, including the Panel's view that the regulator should be established with a view to it gaining further functions as other sectors are transferred to national regimes. This recommendation has direct relevance to the proposed road market reforms discussed

previously in this submission and at Draft Recommendation 3 of the Draft Report, regarding the need for cost-reflective road pricing to be subject to independent oversight.

With regard to independent oversight of road pricing, the Department shares the Panel's views in Chapter 24 regarding the benefits of a single national independent regulator that has the scale of activities to enable it to acquire broad expertise and experience across a range of industries, and to acquire and retain staff who have that expertise. The Department further agrees that such an agency, provided it had a broad remit for pricing all road uses, would be less at risk of industry capture.

The Department is well aware that, as noted in Chapter 24, a multiplicity of regulators can be administratively costly, and require businesses to engage with more than one regulator. This can be amplified in the transport sector, where operators are subject to a range of regulations, international treaty and public interest obligations. In the long term, there may be merit in having national road pricing regulatory functions administered by the same body that oversees transport safety matters, further consolidating sector expertise and promoting consistency in regulatory approaches. It may also assist to balance the economic aspects of road pricing against other public interest considerations, such as safety and community service obligations.