ACCC Takes Nation to Point of No Return

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It is finally being recognised that substantial parts of our infrastructure industries face serious capacity constraints. The factors behind this are complex. There are no magical solutions to which the Commonwealth and State governments can turn. But ‘first do no harm’ seems a reasonable starting point. Australian governments can at least ensure that serious obstacles to infrastructure development created by regulation are addressed.

In particular, the Australian Competition and Consumer Commission’s approach (ACCC) to regulating infrastructure charges creates unnecessary uncertainty for investors in infrastructure industries. This in turn undermines the confidence needed for private capital to want to commit to investments that once made, are almost entirely sunk.

The regulation of natural gas pipelines strikingly illustrates this point. The ACCC has been regulating these pipelines for over eight years. While regulation is indeed complex, one would have thought that eight years would be time enough for the ACCC to have determined, understood and clearly explained the manner in which it would set charges.

Yet, merely a week ago, the ACCC told the Australian Competition Tribunal that its approach to valuing pipelines and other regulated assets – that is, the Depreciated Optimised Replacement Cost (DORC) standard – was inherently “ambulatory”. That is, it could mean quite different things in different contexts. Thus, while the ACCC accepted that it had published screeds of papers on the concept, it accepted no obligation to be held to the approach its papers had originally set out where a different approach to issues such as tax or the setting of the required rate of return would lead to lower charges.

That the ACCC can operate this way reflects deeper problems of attitude. All too often, the ACCC seems to measure its success in terms of achieving price reductions.

Preventing monopoly pricing is indeed crucial. But a clear distinction needs to be drawn between avoiding price gouging and the pursuit of price reductions for their own sake. The first confers benefits in the form of increased efficiency; the second, though popular in the short term, merely discourages investments that would make society better off. Avoiding the latter is what distinguishes sustainable regulation from its populist counterpart.

The ACCC at times gives little sign of having grasped the distinction. For the Productivity Commission’s recent review of the Gas Code, for example, the ACCC submitted a quantification of benefits it claimed the community had obtained from lower charges imposed on pipeline operators. Like all quantifications, this one relied on assumptions. Here the ACCC’s key (though unstated) assumption was that no investment would be needed in pipelines for many, many years, so that effects on the incentives to invest played no role in assessing welfare consequences.

As a result, in the model, community benefits were maximised when pipeline owners’ income was set to zero – or even to negative amounts, given that some pipelines are foreign-owned (payments to those owners therefore being regarded as merely a burden on Australian living standards). Little wonder that foreign investors, faced with such attitudes, should have some hesitation about investing in regulated assets.

The ACCC's attitude is all too often mirrored by its State and Territory counterparts. Reflecting this, the setting of regulated rates of return in Australia has degenerated into a game of limbo, in which jurisdictional regulators compete to see how low they can go. One striking example of this was in October last year when the Queensland Competition Authority issued a draft decision on the Dalrymple Bay Coal Terminal. The decision provided investors with a return little more than 2 per cent above those available from investing in Government bonds. Furthermore, important aspects of the regulatory framework that culminated in this decision were only introduced after the Queensland Government concluded its lease with Babcock & Brown, the current leasors of the Terminal.

As allowed rates of return are driven down, the investments required to service demand increasingly need to be negotiated outside the regulatory framework, as separate and direct bargains between facility users or government on the one hand and facility owners on the other. In some industries, this can work, however unnecessarily complex it may seem. In many others, it is a recipe for long-term failure.

Of course, the ACCC, like its counterparts, disputes all this. Rather than engaging in serious debate on the issues, it commissions doubtful study after doubtful study that unsurprisingly supports its contentions. But as John Adams famously said, facts are stubborn things – and it is those facts that now need to be addressed.

A good place to start would be for the Government to implement in full the recommendations of the Productivity Commission's reviews of the National Access Regime and of the Gas Code.

Additionally, the Government, together with its COAG counterparts, needs to act to more clearly separate regulatory policy from the administration of regulation. Once the Hilmer reforms were in place, the Commonwealth, and most notably the Treasury, abdicated real policy responsibility for infrastructure regulation, allowing the regulators both to make policy and implement it. Numerous reviews pointed to deficiencies in what was being done – but little progress was made in correcting clear flaws in regulatory approaches.

The time has now come for policy responsibility, and the substantial resources used by regulators for policy development, to be shifted back to government. Investors in and users of regulated infrastructure are entitled to clear, transparent and unambiguous formulations of policy in key areas such as the valuation of infrastructure assets and the setting of allowed rates of return. It is against the backdrop of those policies, and operating within the constraints they impose, that regulators should exercise their implementation responsibilities. Until that happens, the uncertainties that hold up infrastructure development will persist, and the constraints we read about every day will only get worse.

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