Ports: What measure of regulation

Speakers:
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ACCC Chairman Rod Sims delivers a keynote address at the Ports Australia Conference in Melbourne. Mr Sims says appropriate regulatory regimes should be in place before assets with monopoly characteristics are privatised. He explains this is best achieved through a negotiate-arbitrate framework. Mr Sims also talks about recent engagement with governments on port regulation and some positive outcomes achieved.

Transcript:

Check against delivery

Introduction

Thank you for the invitation to speak today; it's a pleasure to be in the company of many colleagues who have an interest in port infrastructure.

Privatisation and appropriate regulation of Australian ports has certainly been a hot topic for the ACCC over the last few years. And I'm sure it comes as no surprise to anyone here as to why; ports are critical gateways for goods to be transported by sea with little to no substitutes.

Given this, any monopoly pricing will ultimately be paid for by users and consumers, and damages the productivity of Australia's economy, impeding growth, international competitiveness and living standards.

Now, let me be clear at the outset that the ACCC is not against privatisation. On the contrary, as I have said on numerous occasions, the private sector will usually be a more efficient operator of commercial enterprises than government.

But what the ACCC is concerned about is governments seeking to boost one-off sale proceeds through privatisation processes at the expense of creating a competitive market structure or putting in place appropriate regulation to curb monopoly pricing. This effectively provides one off proceeds but places a 'tax' on future generations of Australians.

The example of the Port of Melbourne seeking to increase rents by 750 per cent at the time of privatisation was an extremely bad look, and damages the case for privatisation.

It was suggested by some that the high rent benchmark was set by the bidder for the third stevedore licence. But let's be clear; if a bidder believes any bid will see the incumbents forced to match it, the bidding process is fundamentally flawed!

While the Port of Melbourne sensibly backed down, rents for DP World will still increase significantly, and these costs will be passed on to port users.

There are four areas that I would like to focus on today.

First, I will suggest that the current preference of governments to implement price monitoring regimes at best, or effectively no regulation at worst, fails to ensure there is an effective constraint on monopoly pricing at Australian ports.

Second, add to this the move by some governments to sweeten the deal for buyers by putting in place arrangements that ensure little to no prospect of future competition. This means you have key infrastructure assets that have an unfettered ability to exploit their enviable situation for years to come.

Third, and related, I will argue that it is wrong to suggest that we should not be concerned about monopoly pricing of infrastructure because the result may be purely a transfer of economic rent. This is very rarely true, it defies commercial and economic logic, and it fundamentally fails to recognise the potentially harmful impact upon investment and innovation along the supply chain.

Fourth, I will refer to the ACCC's recent engagement with governments to highlight the importance of privatising port assets to promote competition and efficiency and our preference for the negotiate-arbitrate regulatory framework.

Price monitoring is not effective for regulating monopoly infrastructure

There is no doubt that regulation is a second-best substitute for competition. Competition, or the credible threat of competition, is the best constraint on the market power of infrastructure owners.

However, inevitably there are situations where the conditions for effective competition are absent; such as where firms have a legislated or natural monopoly. Many of Australia's key infrastructure assets, including ports, exhibit such monopoly characteristics.

Where this is the case, appropriate regulation is needed to act as a constraint on pricing. And it's not difficult to understand why. If you were the commercial owner of monopoly infrastructure without any effective constraint on your pricing, what would you do? Of course you would use the situation to earn high returns over time. To do otherwise would be doing a disservice to your board and your shareholders.

Why allow a monopolist such discretion?

What we have seen over the last few years through privatisation processes is a preference by governments to rely on price monitoring arrangements as a means of influencing monopoly port infrastructure pricing.

Let me clarify that price monitoring can be useful to increase transparency and address a high level of community concern, or where policy-makers are seeking to understand the impact on a market of a change in policy. But it does not amount to any form of regulation. Without competition, simply monitoring prices will not provide any discipline on pricing.

Take for example the Port of Newcastle. This is the world's largest coal export port, and it was privatised in 2014 with a sale price of $1.75 billion. Less than a year later, the new owner revalued its port assets to $2.4 billion and increased navigation charges by over 40 per cent.

There is no effective regulatory regime to constrain monopoly pricing at this port. Instead, there is simply a price monitoring regime. As you may expect, this regime has had no visible impact in dealing with this price increase.

In response to these price rises, Glencore Coal sought declaration of the shipping channel service at the Port of Newcastle under Part IIIA of the Competition and Consumer Act 2010. (May 2015). If a service is declared, this means that an access seeker (in this case Glencore) can seek ACCC arbitration of a dispute with the infrastructure owner.

The NCC's recommendation, and the Minister's decision, was not to declare the service. However, the Australian Competition Tribunal (ACT) recently overturned this decision and declared the shipping channel services. The Tribunal's decision further highlighted concerns about the appropriate regulatory framework for privatising a state-owned monopoly.

It's interesting to note that the ACT and the NCC's recommendation acknowledged that the existing monitoring regime provides effectively no constraint on pricing practices, and that the regime would be highly unlikely to meet the requirements for certification under the National Access Regime. This supports our view that price monitoring is not an effective constraint on monopoly power.

It is also worth noting that Glencore submitted its application for declaration in May 2015. On 14 July 2016 the Port of Newcastle appealed the Tribunal's decision.

It has now been over a year and, given the matter has been appealed to the Federal Court, the access issue is still unresolved. This highlights the need to set appropriate regulatory arrangements upfront and avoid what is proving to be a costly and uncertain process for all parties.

Arrangements that limit the potential for future competition compound the concerns

The credible threat of competition is the best constraint on the market power of infrastructure owners. It follows that, if privatisation is to benefit the economy, it is important that it does not create or maintain a market structure that will hinder potential future competition. In the longer term, a less competitive market structure will lead to higher priced and lower quality goods and services for consumers.

For example, while the privatisation of two potentially competing assets as a package deal may increase the sale price, it comes at a cost of potential future competition to the detriment of users.

Another example is the Victorian Government's clause that will see the lessee of the Port of Melbourne paid compensation if a second port is developed by the Government and in operation in the first 15 years of the lease. To be fair this is a much better outcome than the originally proposed 50 years.

A further example is the NSW Government's reported agreement with the private operator of Port Botany and Port Kembla to compensate it for loss of trade to a competing container terminal in Newcastle.

Schemes like these damage the economy by hindering future competition and entrenching the market power already held by the asset owner.

Monopoly pricing is rarely a transfer of economic rents

Some commentators on the economic regulation of monopoly or near monopoly infrastructure have argued that any monopolistic pricing amounts to a pure transfer of economic rents between parties within the supply chain. That is, the transfer of economic rents between parties within a commodity export supply chain could occur without any impact on the production or investment decisions of users.

Such an argument defies all economic teaching that monopolists charge more and give less.

It also fails to consider the potential harmful impacts on investment and innovation in upstream or downstream industries.

One needs to understand that, in order to produce or extract a commodity like coal, this requires a major sunk investment in mining equipment and infrastructure. These sunk investments give rise to what are known as "quasi-rents" which are subject to the threat of hold-up.

The threat of expropriation of rents by a monopoly service provider in such a situation would only in extreme circumstances result in a pure transfer. More liberty, even the threat of such expropriation can limit future investment and innovation by the upstream firms.

What miner would invest in reducing its extraction costs if it knew that the lower extraction costs would simply be met by higher port charges? More generally, what miner would invest in its mines knowing that the benefits of that investment could be expropriated by a monopoly somewhere else in the supply chain?

My point here is a simple one. To say we shouldn't be concerned about monopoly pricing because it is merely a transfer of economic rents is wrong in economic and commercial logic.

Fit-for-purpose regulation needs to be put in place upfront

With governments facing fiscal challenges, a core objective in privatising assets has often been to maximise proceeds. This is fine if there is a competitive market, or there are sound regulatory arrangements in place to curb monopoly pricing and protect the long term interests of consumers. But as I've noted, the ACCC has been concerned that this has not been the case with many privatised port assets.

The ACCC has been calling for governments to put in place appropriate and effective regulatory arrangements upfront in privatisation processes. It is likely to be more difficult to put an effective regime in place at a later date, once contracts have been signed. It also increases uncertainty to industry, including bidders for the business being privatised, if regulatory arrangements can be applied at a later stage.

It is the ACCC's view that a negotiate-arbitrate framework is the minimum for effective regulation of monopoly infrastructure. This approach doesn't impose upfront requirements on the infrastructure owner, so the regulatory burden is minimal. It allows robust commercial negotiations to take place.

However, it means that users can seek binding independent dispute resolution if they can't agree with the monopoly asset owner on price or other terms of access. This provides an incentive for the asset owner to offer reasonable terms and conditions in order to avoid the process of arbitration, and it levels the negotiating playing field by providing leverage to users.

It's hard to see what anyone would have concerns over for such arrangements; they impose minimal costs and provide strong incentives for parties to negotiate sensibly.

In 2015 the ACCC engaged with the Victorian Government regarding the privatisation of the Port of Melbourne and, more recently, the ACCC has been talking with the WA Government about the privatisation of the Port of Fremantle and the Utah Point Bulk Handling Facility at Port Hedland.

We saw some positive results from our engagement with the Victorian Government last year, with important improvements to the regulatory regime applying to the Port of Melbourne.

The regime includes capping certain charges to CPI for at least 15 years, regular reviews by the Essential Services Commission of the lessee's compliance against strengthened pricing principles, and the ability for more direct forms of regulation to be imposed. Although not perfect, I consider these move the dial towards a more robust regulatory regime to apply post-privatisation, and are more rigorous than measures in place at many other major Australian container ports.

However, an even more pleasing result has been our recent engagement with the Western Australian Government on the proposed privatisation of the Utah Point Bulk Handling Facility.

After the ACCC pointed out the limits of price monitoring to constrain pricing, the WA Government now proposes to replace the monitoring regime with a negotiate-arbitrate framework. We consider that this will provide a credible constraint on monopoly pricing, while still allowing users to commercially negotiate terms of access.

This is a marked improvement to the initial proposal; which suggested benchmarks (such as the CPI) to guide price movements and allowed an ex-post review of price changes and possibly changes to the pricing regime.

On the face of it, using a benchmark such as CPI may seem like a reasonable outcome. However, simply defaulting to CPI price increases does not necessarily mean that prices will reflect efficient costs over time. Firstly, what is the starting point; initially prices may not reflect efficient cost. Further, increasing volumes could mean that the average cost of providing services may actually decrease over time while, at the same time, revenues may increase due to both higher volumes and prices. This could increase the gap between costs and revenues and (potentially) monopoly rents.

And finally, I will touch on the Port of Fremantle, which is the last capital city port in Australia to be privatised. The port, including the Kwinana precinct, handles almost all of WA's container trade, it also handles most of WA's livestock exports, motor vehicle imports, as well as bulk grain and mineral exports.

To date we have expressed concern about the initial proposal by the WA Government to offer the new owner of the Port of Fremantle the first right to develop a new port south of Fremantle in the future. As I've already covered, allowing the owner of the existing facility the right to develop a new port forecloses the potential for future competition between two Fremantle ports. This limits the competitive constraint on the privatised port operator, to the detriment of users.

If the privatisation is to benefit the WA economy, it is important that it does not create or maintain a market structure that will hinder potential future competition. The ACCC is continuing to engage with the Western Australian Government on this issue and the regulatory framework.

Closing remarks

The ACCC is not against privatisation; indeed we are doing a lot to protect it.

We consider that privatising assets solely to maximise sale prices at the expense of competition (either now or in the future) reinforces understandable perceptions that privatisation raises prices, and is a tax on future generations. While governments may have the initial benefit of revenue from the sale, over the long term the impact of reduced competition and efficiency and higher prices will harm consumers and the economy.

To avoid this, appropriate regulatory regimes should be in place before assets with monopoly characteristics are privatised. From our perspective, this is best achieved through a negotiate-arbitrate framework.

So far we have achieved some positive outcomes in our engagement with some governments. Moreover, it has been heartening to see the public debate re-invigorate discussions around competition and efficiency objectives.

Thank you.

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