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SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY

THE NATIONAL ACCESS REGIME

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1 Introduction

1.1 Rio Tinto and the National Access Regime

Rio Tinto has been significantly affected by the National Access Regime

1. Rio Tinto has already been affected by the National Access Regime (NAR) in two important ways. First, it has been subject to an application for declaration of its iron ore railways in the Pilbara. Second, it has been involved in attempts to secure improvements in the performance of the state-owned, coal-carrying railways in NSW and Queensland, which have included use of the NAR. The NAR has the potential to have further significant impacts on Rio Tinto's operations in the future. Rio Tinto considers that its experiences have highlighted deficiencies in the NAR that need to be addressed.

Efficient bulk freight rail systems essential to Australia's mining industry

2. Access to efficient bulk freight rail systems is vital to maintaining the competitiveness of much of Australia's mining industry. In 1999-00 the five most important Australian mineral exports by value were, in order, coal, bauxite/alumina/aluminium, crude oil, gold and iron ore. The first, parts of the second and the fifth are bulk commodities whose cost structure is significantly affected by the cost of transport services. Energy is a major input into the refining of alumina and the smelting of aluminium. Burning coal frequently provides that energy. The cost of transporting that coal from mine to power station is a significant factor in the cost competitiveness of those industries. Taken together exports of these three groups of commodities earned Australia over $19b in 1999-00, accounting for over 26% of the value of Australia's commodity exports.

Rio Tinto businesses must remain competitive

3. Rio Tinto operates in highly competitive, international markets. To maintain profitability over the long haul and provide a return on capital employed, a mine must develop and sustain a position low on the world supply curve for the mineral in question. For most minerals and mineral products, world supply curves are shifting downwards at rates of up to 3% a year in real terms. For example, the world supply curve for iron ore has been shifting down at 2.5 – 3.5% a year for some time. In fact over the last decade and a half, the price of iron ore in real, US dollar terms has almost halved. To maintain a position low on such a downward shifting curve requires a continuing improvement in performance so that mine costs match that downward march. Mines that fail to keep pace cease to be viable.

Rio Tinto has a breadth of experience

4. The Rio Tinto Group owns and operates an extensive iron ore railway in the Pilbara and a small bauxite railway in Queensland. It is an extensive user of the "common carrier" services of the State rail systems in Queensland and New

South Wales. Overseas, the Kennecott Energy Company, a major US coal miner, relies on rail freight to deliver nearly all its output. Rio Tinto is thus well placed to compare the performance of a variety of different rail systems.

1.2 The Submission

Structure of submission

5. The next part re-examines the approach and objectives of a NAR as formulated in *National Competition Policy*, the Hilmer Report.[1] Part 3 describes Rio Tinto's experiences of the NAR. Drawing on the previous two parts, Part 4 identifies some shortcomings in the NAR as it now operates. The last part offers some brief conclusions. Rio Tinto's interests are chiefly in access to rail services and there has been a number of reviews of Australia's rail system in the last couple of years.[2] Those reviews contain much material that is relevant to this inquiry. Rather than redevelop arguments that have been extensively canvassed in those reports, this submission quotes selectively from them. Rio Tinto made submissions to a number of those inquiries and cross-references to that material have also been made where appropriate.

2 Objectives of the National Access Regime

The Hilmer report provides context

6. The NAR was introduced in response to the Hilmer report. That report contained a careful analysis of the case for introducing such a regime, the form such a regime should take and the importance of applying it with care. It is worth briefly revisiting that analysis to provide context for this review of the first five years of the NAR's operation.

2.1 Improved welfare through increased competition

The objectives of reform

7. The focus and principal driver of the analysis and recommendations offered in the Hilmer report was made clear in the opening sentence of the executive summary. It read

> "Australia is facing major challenges in reforming its economy to enhance national living standards and opportunities."[3]

The report saw those benefits being delivered by responding to the imperative that

> "Australian organisations, irrespective of their size location or ownership, must become more efficient, more innovative and more flexible."[4]

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[1] Commonwealth of Australia (1993).

[2] These report have include Productivity Commission (1999a), (1999b), House of Representatives.(1998) and Commonwealth of Australia (1999a).

[3] Commonwealth of Australia (1993), page xv.

The principal legislative vehicle for the reforms, the amendments to the *Trade Practices Act* (TPA), captured the same themes in a new object

> "The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection."[5]

Therefore, the critical test in assessing the performance of those reforms should be the extent to which national living standards and opportunities have been enhanced.

A legal instrument directed to an economic objective

8. In the case of this inquiry we are dealing with a legal instrument, the NAR chiefly implemented by the introduction of Part IIIA to the TPA, directed to an economic objective. Other aspects of the TPA are directed to objectives of different kinds, for example, the elimination of conduct the community regards as criminal, immoral or otherwise unacceptable. Judgements about these parts of the Act would involve consideration of community values and mores. Assessing the performance of Part IIIA is, at least in principle, rather easier. The key question is whether its operation has enhanced the living standards of the Australian people. In making this assessment it is important to bear two things in mind. First, although both the Hilmer report and the TPA identify the principal mechanisms through which they expect benefits to be delivered, eg in the new TPA objective quoted above, these mechanisms are the means to an end not the end itself. Second, there are costs associated with the operation of the regulatory regime embodied in Part IIIA. To achieve its objective, the NAR must not simply deliver some benefits but sufficient benefits to outweigh the costs of obtaining them. It will be apparent below that some aspects of the NAR are proving relatively costly to operate, making this point more than academic. The point gains further weight when it is recognised, as the Hilmer report did, that there may be costs to the NAR beyond those that are directly measurable like the cost of legal process.

The Hilmer report primarily concerned with domestic markets

9. The Hilmer report recognised that competition policy had linkages to other issues like trade policy and consumer protection. However, based on its terms of reference the committee took the view that its primary focus should be the effects of competition in domestic markets on efficiency.[6] As is recognised in international trade theory, the familiar arguments about the benefits to a national economy of competition in domestic markets can only be extended to competition in international markets if certain conditions are fulfilled. It is far from clear that these conditions are fulfilled in all the international markets in

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[4] ibid., page 1.

[5] *Trade Practices Act* 1974, section 2.

[6] "Policy governing the extent of competition from international sources – an important part of trade policy – is treated as distinct from competition policy, notwithstanding it s similar effects in terms of competition in the domestic market." Commonwealth of Australia (1993), footnote 7, page 6.

which Australia participates. The framing of Part IIIA seems to have overlooked this point. The potentially damaging implications of this are explored in more detail below.

2.2 Reform of state-owned enterprises

A major focus on state-owned enterprises

10. The second part of the Hilmer report, titled "Additional Policy Elements", was concerned with areas that were then outside the TPA. It particularly emphasises the anti-competitive nature of much government regulation and the scope for substantial gains from the structural reform of public monopolies. Chapter 11 of this part of the report, titled "Access to 'Essential Facilities'", developed the recommendations for the introduction of a NAR. Even though the NAR recommended by the Committee was to apply to all facilities regardless of ownership, the reform of state-owned enterprises is a key, recurring theme of this chapter. For example

> "In designing the regime the Committee was conscious that almost all cases of essential facilities identified for the Committee were in the public sector because of the history of government ownership of infrastructure."[7]

and

> "A mechanism of this kind seems likely to play a pivotal role in a national competition policy as competition is introduced to areas previously reserved to public monopolies."[8]

States had particular concerns

11. The States and Territories had a number of concerns with the recommendations of the Committee. In fact its reporting deadline was extended by several months to permit further consultations with the States and Territories. The report gives these concerns special consideration in separate section of Chapter 11, but finally concluded that

> "A number of concerns were raised in submissions and discussions with States that might arise from the application of an access regime to State-owned assets. In the Committee's view, none of these concerns provides a reason for excluding State assets from an access regime, although these special considerations should be taken into account."[9]

The extent to which the NAR embodied in Part IIIA can be said to apply effectively to the States and Territories is a matter discussed in some detail below.

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[7] ibid., page 239.

[8] ibid., page 242

[9] ibid., page 260

2.3 Application to privately-owned facilities

Clear public interest needed to justify legislated access

12. While the Hilmer report saw considerable benefit flowing from the application of a NAR to some of the facilities of state-owned monopolies, the approach to privately owned facilities was much more cautious. First the chief candidates for declaration under an NAR were seen to be in the public sector as here

> "Many of the facilities potentially subject to an access regime are currently owned by Commonwealth, State and Territory Governments. This is particularly so of key infrastructure assets such as electricity transmission grids, rail tracks and the telecommunications network, and the Committee was cognisant of this fact in designing the general rules outlined above."[10]

Second, the dangers of an injudicious application of an NAR were clearly recognised as here

> "The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to owners of such facilities has the potential to undermine incentives for investment."[11]

The Committee regarded this as important enough to recommend that it should be explicitly taken into account when deciding whether to grant access, as here

> "Moreover, when considering the declaration of an access right to facilities, any assessments of the public interest would need to place special emphasis on the need to ensure access rights did not undermine the viability of long-term investment decisions, and hence risk deterring future investment in important infrastructure projects. Accordingly, wherever possible the likely obligations to provide access should be made clear before an investment is made, whether that be through licensing requirements of a new facility or the acquisition of an asset formerly owned by government. Where this is not possible, due account of the likely impact on incentives to invest should be made in determining whether or not to create a right of access, and if access is declared, through the declaration of appropriate pricing principles and other terms and conditions."[12]

Having weighed these potential dangers, the report concluded

> "Nevertheless, there are some industries where there is a strong public interest in ensuring that effective competition can take place, …. The telecommunication sector provides a clear example, as do electricity, rail and other key infrastructure industries. Where such a clear public interest exists, but not otherwise, the committee supports the establishment of a legislated right of access, …"[13]

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[10] ibid., page 260.

[11] ibid., page 248

[12] ibid., page 251.

[13] ibid., page 248

Criteria expected to limit cases where access would be granted

13. The report went on to develop criteria that could help establish when this "clear public interest" exists. The first of these was that

> "Access to the facility in question is essential to permit effective competition in a downstream or upstream activity"[14]

This is different in important respects from the corresponding criterion in Part IIIA. Some of the implications of this are discussed below. In respect of the number and type of cases that would meet the criteria the Committee first noted that

> "These criteria may be satisfied in relation to major infrastructure facilities such as electricity transmission grids, major gas pipelines, major rail-beds and ports, but not in relation to products, production processes or most other commercial facilities. While it is difficult to define precisely the nature of the facilities and industries likely to meet these requirements, a frequent feature is the traditional involvement of government in these industries, either as owner or extensive regulator."[15]

This again reflects the Committee's view that the primary area of application of the NAR they were recommending would be state-owned monopolies, not privately owned facilities. Overall the Committee expressed the view that access would be granted in relatively few cases, recommending that

> "In practice, however, such a regime should be applied sparingly, focussing on key sectors of strategic significance to the nation."[16]

It is interesting to compare these expectations with the experience of the last five years.

2.4 Summary

14. In summary, the Hilmer report saw the objective of an NAR, indeed of all competition policy reforms as to "enhance national living standards and opportunities", expected the major gains to come from the application of the regime to state-owned monopolies and expected the number of cases where sufficient "clear public interest" could be established to justify the granting of access to be relatively few and predominantly in the public sector. The report emphasised that all the implications of granting access to privately owned facilities should be weighed carefully before access was granted and that adequate safeguards for the facility owner's interests should be provided when access was granted.

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[14] ibid., page 251.

[15] ibid., page 251.

[16] ibid., page 260.

3 Rio Tinto's Experience of the NAR

Two sources

15. Rio Tinto's experience of the NAR has come from two primary sources: dealing with the state-owned rail systems in NSW and Queensland and running its own rail system in WA. Those experiences are described here.

3.1 Experience in NSW and Queensland

Two issues

16. There have been two, related but distinct, principal complaints about the services provided to and charges levied on the coal mining industry by the State-owned rail authorities. The first is that the authorities or their owning governments exploited their monopoly power to levy charges incorporating a sizeable monopoly rent component. The second was that the lack of competition led to substandard performance by service providers, reflected in charges that were higher than they should have been (after allowing for the monopoly rent component) and inefficiencies in service provision that reduced the competitiveness of the coal companies using those services.[17]

Activity

Declarations yet to be obtained for State rail systems

17. NCC has dealt with applications for declaration of parts of the NSW and Queensland rail systems. The NCC recommended that the Queensland services not be declared because some of the elements could be economically duplicated. The designated minister, the Queensland Premier, accepted the recommendation and did not declare the service. That decision is in process of review by the Australian Competition Tribunal (ACT). The NCC recommended that an application, lodged by the NSW Minerals Council in April 1997, for declaration of a service known as the Hunter Railway Line Service be accepted. The designated Minister, the NSW Premier, allowed the 60 day period for decision to lapse, resulting in the Minister being taken to have made a decision not to declare.[18] This decision was appealed to the ACT, but hearing of the appeal was delayed by an application to the Federal Court to halt the process because government coal carrying services were excluded from the access regime for five years.[19] In October 1998, the Federal Court found that the Hunter Railway Line Service was not covered by the exclusion. The appeal continued, but was complicated by an application by the NSW government to have its rail access regime certified as effective, a step that would preclude the service being declared. The NSW Minerals Council withdrew its application in

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[17] More detail on these complaints and recent attempts to address them is given in Rio Tinto (1998), pages 6-9.

[18] Pursuant to *Trade Practices Act* 1974, section 44H(9)

[19] *Competition Policy Reform Act* 1995, section 78.

December 1999 after the regime was certified.[20] Other cases have ended when applications were withdrawn, in one case of a freight forwarder, because alternative arrangements for access in the future were made.[21]

Limited certification of State regimes for rail access

18. In both NSW and Queensland, access regimes for rail services have been introduced through State legislation.[22] In neither case was there appropriate consultation with key stakeholders. In June 1997, the NSW rail access regime was submitted for certification as effective in terms of the TPA and the *Competition Principles Agreement* (CPA). Although the Minister for Financial Services and Regulation ultimately certified the regime in November 1999 on the recommendation of the NCC, it is not clear that the regime certified by the Minister was the one considered by the NCC.[23] Moreover, the regime was only certified until the end of 2000. The Queensland rail access regime was submitted for certification in June 1998. The application was withdrawn in February 1999, with the Queensland government claiming that it remained committed to working towards certification with the NCC. With the withdrawal of the application, the NCC work on the regime has ceased. The only other rail access regime to have been certified covers the existing Tarcoola to Alice Springs railway and the proposed Alice springs to Darwin railway. This certification extends until 2030.

Results

Some progress on rail freight charges, but major concerns remain

19. Charges for coal freight are falling. For example, in NSW, the royalty component in freight charges has largely been removed, with freight rates falling by as much as 50%. While this is to be welcomed, a number of significant concerns remain. Do the lower prices match international performance benchmarks? Are they underpinned by secure gains in efficiency? Although increased competition for coal haulage contracts has clearly contributed to more aggressive pricing by state-owned entities, it is not clear that this pressure will be sustained. Service quality still leaves much to be desired.

Rail freight prices may still be too high

20.. The recent Productivity Commission report on black coal mining concluded that “operating costs of Australian coal rail freight appear to be 20 to

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[20] More detail on the tortuous progress of this application is given in NSW Minerals Council (2000).

[21] The company involved was Specialized Container Transport.

[22] In both States the legislative arrangements have been relatively complex. Chapter 7 of Productivity Commission (1999a) discusses them in more detail.

[23] More detail on this complex sequence of events is provided in NSW Minerals Council (2000).

30 per cent higher than major North American railways."[24] Experience in Rio Tinto, both as an Australian rail operator and as a user of overseas rail systems, suggests this is a conservative estimate of the scope for improvement. The Productivity Commission report also concluded that "the productivity of coal rail freight services in Australia is somewhat lower (by around 20 per cent) than that of better overseas operations."[25] Again this is an estimate that Rio Tinto believes underestimates the scope for improvement.

Have structural improvements been secured?

21. Of more concern than the fact that the performance of Australian coal haulage railways may lag world's best practice is that the slow improvement that has been seen may not continue and may even be reversed. The Productivity Commission noted that

> "However, many coal producers have observed that the lack of competition in rail services has been a barrier to making the 20 per cent efficiency jump to better practice levels. Comments on the introduction of rail access in NSW support this view that competition is needed to generate better performance."[26]

Although, as already noted, the perceived threat of competition has led state-owned enterprises to "sharpen their pencils", that perception could clearly alter if progress towards facilitating access to rail services for alternative coal haulers is not sustained. The benefits that have been obtained by the coal companies have been due in no small measure to the very substantial efforts that they have made to improve transparency on rail access charges and identify areas where savings were possible. It is difficult to see how the companies concerned could manage to commit the resources required for this activity on a permanent basis. Without structural change, not only are the prospects for further progress clouded, but gains recently made are also at risk.

Some improvements in transparency, but service remains poor

22. Largely because of the efforts of the coal companies, there have been some improvements in the transparency of rail access regimes. In NSW the involvement of the Independent Pricing and Regulatory Tribunal (IPART) has been helpful. IPART has set a more reasonable target nominal after tax rate of return on capital of 8%, down from 14%, and is conducting a more soundly based assessment of asset values. In Queensland progress has been slower, but work on a Draft Rail Determination has continued and a new consultation draft is due to be circulated shortly. Service quality, however, remains poor. Track management is not of an acceptable standard and there still seems to be an unwillingness to invest in needed infrastructure improvements.[27] The continuing failure to address the vertical integration of State rail entities in

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[24] Productivity Commission (1999a), page 180.

[25] ibid., page 175.

[26] ibid., page 185

[27] The impact of this on the competitiveness of coal companies was discussed in Rio Tinto (1998), page 14.

Queensland remains a significant barrier to effective reforms.[28] The impact of recent changes in rail system management in NSW, outlined below, is still uncertain.

Some reforms being undone

23. Although not directly the subject of the terms of reference of this inquiry, recent changes to the structure of rail services provision in NSW are of concern. Through legislation assented to earlier this month, the NSW Government has re-combined the Rail Access Corporation and Rail Services Australia into a new state-owned corporation, the Rail Infrastructure Corporation (RIC). The lack of competition in rail maintenance services under the previous arrangements had already caused concern, with the Productivity Commission noting that

> "The performance improvements already reported suggest that delaying the impact of competitive forces by restricting competitive tendering and contracting, and by failing to develop acceptable rail access regimes ... will be expensive for rail freight users."[29]

In addition the new legislation gives increased powers of direction of the rail entities to the Co-ordinator General of Rail Services and the Minister and "modifies the objectives of the Rail Infrastructure Corporation so that they are more closely aligned with, and mutually support, those of the State Rail Authority".[30] The critical issue of train control has also been left in some confusion by the new Act with control residing with the RIC, where it properly belongs, except that the Minister may place control over particular parts of the system with an operator.[31] In its submission to the Productivity Commission inquiry *Progress in Rail Reform*, Rio Tinto noted that

> "Operation of the system is presently dependent on the pre-existing relationships among the various components of the old State rail monopoly conglomerates."[32]

It seems fair to ask: is anything changing?[33]

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[28] The issue of vertical integration is discussed in Rio Tinto (1998), pages 5-6, 8 and 14.

[29] Productivity Commission (1999), page 186.

[30] Extract from the second reading speech, Parliament of New South Wales (2000), page 10066.

[31] The importance of effective use of train control to efficient operation of the rail system was discussed in Rio Tinto (1998), particularly page 14.

[32] Rio Tinto (1998), page 15.

[33] These criticisms should not be read as Rio Tinto questioning, in any way, the Government's fundamental objective in introducing this legislation, namely to ensure that the tragic events that occurred at Glenbrook on 2 December 1999 are not repeated. Rio Tinto's experience of operating in an industry with many inherent risks is that well managed enterprises have better safety records. It does not seem to Rio Tinto that the new Act will improve the management of the NSW rail system.

3.2 Experience in WA

Introduction

24. The most important impact of the access regimes on private rail systems has been felt amongst the iron ore producers of the Pilbara. Rio Tinto through its wholly owned subsidiary Hamersley Iron (HI), was directly involved. This section describes that experience. First, some background on the iron ore rail systems of the Pilbara is provided.

Iron ore railways of the Pilbara

25. The description here is based on the operations of HI.[34] The operations of the other iron ore producers in the Pilbara are similar. There are three independent rail systems in the Pilbara, each dedicated to the iron ore production operations of their owner.[35] Conversion of newly mined ore at each of several mine sites to the saleable product that is loaded onto customers' ships at the port is a complex process, involving a number of operations including mining, hauling, blending and ship loading. Minimising the cost of producing saleable product is essential to the iron ore producers and this has been achieved by closely integrating each stage of the iron ore production process. As with many other modern production processes, integration has proceeded to the point that, if one component of the system fails to perform as planned, the whole of the process is put at risk. Because of this close integration, the rail system plays the same role in the production process as a shovel, a drill or a reclaimer. It is plant integral to the production process and not separate infrastructure that could readily provide services to others. The nature of the process of producing iron ore in the Pilbara was recognised by the House of Representatives Committee in its report, *Tracking Australia*, when it noted that

> "The potential disruption of third party access to highly integrated operations, such as mine to port hauling operations, may also have implications for future investment in private infrastructure. … One obvious concern is that the private sector may simply stop investing in the development of infrastructure facilities where uncertainty over potential third party access exists."[36]

Application for declaration

26. In September 1998, Robe River Iron Associates (Robe), lodged an application with the NCC for the declaration of a service claimed to be provided by the "Hamersley Rail Infrastructure Facility", the "Rail Track Service". Robe was planning to develop a new mine at West Angelas, some 65km south west

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[34] More detailed descriptions of the process of iron ore production in the Pilbara can be found in Federal Court of Australia (1999), pages 9-11 and 16, and Rio Tinto (1998), pages 10-11.

[35] Since the events about to be described, Rio Tinto has purchased North Limited, giving it an interest in two of the three principal iron ore producers in the Pilbara. Nevertheless, at this stage, the three rail systems are still operating independently.

[36] House of Representatives (1998), page 74.

of Yandicoogina, the westernmost of HI's mine sites, and some distance from Robe's existing rail system. Robe sought to make use of part of the HI rail system to link this new mine to its existing rail system.[37] For the reasons given above. HI considered that the "Rail Track Service" was part of a production process. It lodged an application with the Federal Court in October 1998 seeking a declaration that the "Rail Track Service" was not a service within the meaning of section 44B of the TPA and could not, therefore, be recommended for declaration by the NCCC. This section of the TPA provides that, for the purposes of Part IIIA, the term "service" does not include "the use of a production process". Hearings on the case were held in the latter part of April 1999. In June 1999, Justice Kenny brought down a judgement providing the declaration that HI had sought.[38]

Substantial volume of resources expended

27. The formal process described above stretched over some nine months and involved six days of Federal Court hearings. There were seven respondents in the case. While the case was proceeding, there was substantial activity associated with the processes of the NCC. Following receipt of the application, the NCC issued a discussion paper in September 1998 and invited submissions from interested parties. HI and others, including Hope Downs Management Services and Wright Prospecting, both associated with other prospective mines in the Pilbara, as well as BHP Iron Ore and the West Australian Government, filed submissions. The HI submission ran to some 235 pages and included four consultants reports. Following further discussions with the parties, the NCC issued a further discussion paper in March 1999 and requested further submissions from interested parties. It also convened an economists' forum on the issues for May 1999, but this was subsequently cancelled. Overall a substantial volume of resources from a variety of sources were expended in resolving this matter.

Impact on the Pilbara iron ore producers

28. From the time it became apparent that an application for declaration was likely to be lodged until the judgement was brought down in the Federal Court case, there was considerable uncertain about the likely future returns from the investments in the Pilbara. Any threat to these investments is likely to have serious national consequences. They are large. For HI, over $2 billion is tied up in the rail system alone. Although much of the investment in the Pilbara took place some time ago, substantial new investments have recently been committed or are under consideration. Within the last decade, BHP and HI have opened the large iron ore resource at Yandicoogina. A new mine site at West Angelas is scheduled to open within the next few of years. Any increase in perceived sovereign risk uncertainties in Australia would have grave implications for a broad range of national investments. While the uncertainty

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[37] Precise details of the service for which declaration was sought can be found in Federal Court (1999), pages 5-7.

[38] See Federal Court (1999). HI had also sought a declaration concerning an agreement made in 1963. The Court declined to make such a declaration.

about the status of the HI rail system has been removed by the Federal Court, it is important to recognise that the decision in that case was only reached after Justice Kenny had very carefully analysed the specific character of HI's operations. It is hard to see how the judgement can give broad comfort to private owners of substantial infrastructure investment.

Consistent with the expectations expressed in the Hilmer report?

29. As outlined earlier, the Hilmer report expressed a clear view about how it thought a NAR ought to impact on privately owned facilities. It is interesting to compare the experience of HI and the other parties to these proceedings with that view. Some attempt to do that is made in the next part of this submission.

3.3 Summary

Australian rail systems are diverse

30. The following comments were offered in an earlier Rio Tinto submission. They are also directly relevant here.

> "One of the facts that Rio Tinto's breadth of experience throws up is that Australian rail systems are diverse. In particular, differences between the history and geography of the western and eastern States, as well as the economic imperatives of the industries that have been established there, have produced very different kinds of rail systems within the two regions. These differences extend beyond differences in ownership, major rail systems in the west being privately owned whereas all the significant rail systems in the east are publicly owned. Privately owned rail systems in the west were designed from the start to be fully integrated into the production systems of which they are part. This is a pattern of development quite different to that experienced earlier in the eastern States, where State governments played the major role in providing "common carrier" infrastructure services across the region and it was not open to the coal companies to develop their own rail systems. In designing policy to enhance community welfare, it is vital that these differences be recognised. Failure to do so risks very substantial damage. The reform process, as it has been experienced to date, has impacted very differently on the privately owned systems in the west and the State-owned monopolies in the east. Both sets of impacts need to be carefully considered in assessing the progress of reform and recommending measures to enhance the flow of benefits."[39]

4 Shortcomings in the NAR

Two principal problems

31. Rio Tinto's experience set alongside the objectives and expectations of the Hilmer report point to two principal problems with the operation of the NAR

- the NAR has been ineffective where potential gains are greatest

[39] Rio Tinto (1998), pages 2-3.

- the NAR is applying too widely, likely leading to reductions in community welfare in some cases

4.1 Ineffective where scope for gains is greatest

Potential gains large, NAR a key instrument

32. As discussed above, the Hilmer report clearly indicated a belief that there was major scope for improvements in community welfare through the reform of state-owned, monopoly infrastructure industries. The Hilmer report also makes clear that reform would involve a number of elements. In the wake of the report, three principal mechanisms were established. These were changes to the TPA (coupled with changes to corresponding legislation in the States and Territories), agreements between the governments, principally the CPA, and continuing pursuit of the reform agenda of the Council of Australian Governments. In the case of rail, there has been little progress on the elements of reform in the latter two areas.[40] This has put greater weight on the NAR as an instrument for securing improvements. Against this background, the difficulty of obtaining access to rail services in NSW and Queensland on satisfactory terms, described above, is a cause for special concern. As noted earlier, some benefits have been delivered to the rail system's customers, but the situation is worryingly fragile.

A flaw in the NAR

33. The history of applications for declaration of services provided by State-owned rail systems in NSW and Queensland described earlier suggests that a problem with the operation of the Part IIIA of the *Trade Practices Act* is emerging. The decision-maker under Part IIIA of the Act is the "designated Minister", who is the responsible Commonwealth Minister unless the provider of the service that is the subject of the application is a State or Territory body, when it is the relevant Premier or Chief Minister. This creates a clear conflict of interest. Its impact can be gauged by the fact that, of the four applications to date, three have resulted in recommendations by the NCC for declaration of services provided by State-owned rail systems but none have been declared. In two of the cases the Premier of NSW allowed the 60-day period for decision to elapse resulting in the service being deemed not to be declared. In the other the Premier of Western Australia decided not to declare the service in spite of an NCC recommendation to do so.

Declaration decision-making needs reconsideration

34. The Hilmer report considered the case of access to facilities owned by governments, first pointing out that

> "Indeed, as these assets are held on behalf of the public, the benefits to the public of improving the efficient use of those assets, and improving the

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[40] The failure of the CPA and the COAG to deliver needed reforms and some of the reasons for that are discussed in Rio Tinto (1998), particularly pages 5-6 and 17-19.

> competitiveness of the economy generally, will usually be additional factors supporting the creation of an access regime."”[41]

The report went on to discuss the reasons why a government might resist an application for access, concluding that none of these had any but transitory significance. While generally accepting the principle of comity between governments in the Australian federal system and recommending cooperative arrangements wherever possible, the report concluded that

> “Where agreement is not forthcoming, however, the Committee considers the important national interests at stake in some circumstances may be sufficient to justify possible unilateral action by the Commonwealth, subject to the safeguards outlined above.”[42]

Accordingly, the report recommended that

> “Access rights be created by a process of declarations made by the designated Commonwealth Minister.”[43]

It is timely to reconsider the analysis offered by the Hilmer report.

Tracking Australia *also identified the problem*

35. The report by the House of Representatives committee, *Tracking Australia*, also recognised the problem. It was particularly concerned that a State minister could simply ignore a recommendation from the NCC that services provided by a State-owned entity be declared. By ignoring a recommendation a State minister could ensure a service was not declared, under the 60-day provision described above, without being required to give any reasons for rejecting a recommendation of the NCC. *Tracking Australia* recommended that the relevant provision in Part IIIA be modified so that failure by a State minister to make a decision on an NCC recommendation to declare a service within 60 days would result in that service being declared.[44] The report commissioned by the Prime Minister, *Revitalising Rail*, picked up this recommendation and urged that it be given consideration.[45] In the circumstances that have been described in this submission, adopting this recommendation would seem to be the least response necessary.

Certification of access regimes

36. Since the States are readily able to frustrate any applications for declaration of services provided by State-owned entities, there is little incentive for them to seek certification by the designated minister on the recommendation of the

[41] Commonwealth of Australia (1993), page 260.

[42] ibid., page 265. The chief safeguard was that the Commonwealth Minister would only act on a recommendation of the NCC, a body jointly administered by the Commonwealth and the States and Territories.

[43] ibid., page 266.

[44] House of Representatives (1998), page 76.

[45] Commonwealth of Australia (1999a) page 42.

NCC of any access regimes they may put in place. The experience of seeking to establish satisfactory access regimes described earlier testifies to this lack of incentive. The Commonwealth has indicated that it regards the Australian Rail Track Corporation (ARTC) as the chief instrument for achieving satisfactory access arrangements.[46] To date, there has been little sign that the ARTC is an effective presence in bulk fright haulage in NSW and Queensland. When the Minister for Financial Services and Regulation certified the access arrangements in NSW, he extended that certification only until the end of 2000 on the basis that national rail access arrangements could be expected to be in place by then.[47] There seems little prospect of that now. Higher priority needs to be given to having State rail access arrangements certified as effective.

4.2 Able to be applied too widely

At variance with the Hilmer report criteria

37. The earlier discussions showed that the Hilmer report was especially concerned about the danger of damaging "national living standards and opportunities" by injudicious application of a NAR to privately owned facilities. The report suggests incorporating various safeguards in the regime to avoid this danger. One aspect of this is the report's formulation of the criteria that must be satisfied before declaration could be considered. The first of these was

> "Access to the facility in question is essential to permit effective competition in a downstream or upstream activity"[48]

It is interesting to compare this with the corresponding provision in Part IIIA, which reads

> "that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service"[49]

The test proposed by the Hilmer report is much stronger, "essential to permit effective competition" rather than "promote competition". This is consistent with the concern that runs through the report to ensure that the scope for gain is sufficiently large to offset the likely direct and indirect costs of providing access. It is interesting to note that the CPA stayed much closer to the Hilmer report

> "access to the service is necessary in order to permit effective competition in a downstream or upstream activity"[50]

Concerns about this widening of coverage have been given added weight by a recent ACT decision.[51] The second important difference is the inclusion of the

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[46] Commonwealth of Australia (2000), pages 3-4.

[47] Commonwealth of Australia (1999b), page 6.

[48] Commonwealth of Australia (1993), page 251.

[49] *Trade Practices Act* 1974, section 44G(2)(a).

[50] *Competition Principles Agreement* 1995, clause 6(1)(b).

phrase “whether or not in Australia” in part IIIA. While the criterion in the report is silent about overseas markets, it is reasonable to conclude from the focus of the report, including its discussion of its terms of reference quoted earlier, that the markets the Committee had in mind were domestic ones.

Commercial motivation can be relied on

38. The distinction is critical because, while it is a reasonable presumption that that an increase in competition in global markets would bring global benefits, it will not necessarily “enhance national living standards and opportunities” – ask a woolgrower. Indeed, under certain conditions, the Australian community may actually suffer detriment from increased competition in a global market in which it trades. It may not be immediately evident whether an increase in competition in a specified global market will benefit or harm Australia. It turns out, however, that the conditions under which Australia would benefit are precisely those when a commercially motivated facility owner would grant access to a service permitting such an increase in competition. The logic was summarised as follows in the Productivity Commission report *Progress in Rail Reform*.

> “To transport iron ore to the port, a new mining operation situated close to an existing track could either:
>
> . develop its own integrated operation by duplicating the existing infrastructure; or
>
> . seek access to the existing infrastructure and so increase rail usage along a track.
>
> In either case, the increased supply of the product from the new operations may depress world prices for both existing and new operations. A commercially focused new operator would only build its own integrated operation if its expected revenues are greater than the cost of building and maintaining its track. It would prefer to use existing track if the costs of building and maintaining its own track are greater than the costs of negotiation and the access price agreed with the existing infrastructure owner. If spare capacity exists along the line, then the existing owner would only deny access to a new operator if:
>
> . the new operator imposed additional costs on the existing operator, for example through damaging the track; and
>
> . the existing operator was not able to negotiate an access fee large enough to compensate for the additional costs or the revenue forgone; or
>
> . lower world prices from additional competition impaired the viability of existing operations.
>
> Denying access implies that the access charge (reflecting the anticipated benefits to the new operator) is insufficient to compensate the existing owner and cover the costs of negotiation. The commercially negotiated outcome (no access) would coincide with the national interest because either the new operator builds its own line or the proposal was not viable. Mandatory access

[51] Australian Competition Tribunal (2000).

> would therefore not improve national welfare and may in fact prove to be harmful."[52]

This provides a strong argument for restricting the coverage of the NAR to cases where the increase in competition resulting from access, if granted, occurs in a domestic market or markets.

Rio Tinto experience compared with Hilmer report expectation

39. The Hilmer report sought to establish a NAR that would only apply to privately owned facilities when the scope for gain was significant and substantial enough to outweigh the direct and indirect costs of providing access. Rio Tinto's experience in WA has been of a substantial expenditure of public and private resources dealing with a case in which there were strong grounds for believing that, not only was there little prospect of enhancing national living standards and opportunities, but a substantial risk of damage to them. This cannot have been what the Hilmer report intended. [53]

5 Conclusion

Failing to meet its objectives

40. The experience of Rio Tinto strongly suggests that, in significant areas of its recent sphere of application, the NAR is failing to meet its objectives. Where there is clear scope "to enhance national living standards and opportunities", the NAR is making little contribution to exploiting it. In other areas, the NAR is consuming disproportionate resources on cases that offer at least as much prospect of doing harm as delivering benefit. This review is timely. The NAR should receive serious reconsideration by government. In that reconsideration, Rio Tinto believes primacy should be given to the fundamental goal of reform: improving the welfare of the Australian people.

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[52] Productivity Commission (1999b), page 164.

[53] Various elements of this situation have been recognised elsewhere. See, for example, House of Representatives (1998), paragraph 4.54.

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