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2012 Pricing and Access Review
Essential Services Commission of SA
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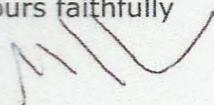
Dear Mr Peter Lim

Thank you for inviting comment on the price and access regimes established under the *Maritime Services (Access) Act 2000*. It is our pleasure to present for your consideration this submission on the matter.

The regulatory framework in which South Australian ports exist is contingent on the Commission's periodic reviews. These reviews are important, given the lack of publicly available information on privatised port corporations such as Flinders Ports Pty Ltd. Whilst financial reports are available through ASIC, the information contained in them is not sufficiently disaggregated to enable an assessment of the performance of individual ports within the company. As a result, port users and members of the public rely on the Commission to monitor and prevent regulated operators from misusing their market power.

The attached submission focuses entirely on the ports price regime.

Yours faithfully



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Has the Commission's present form of price regulation (i.e. price monitoring) been appropriate and effective in deterring market power from being misused?

1. Methodology of price regulation

The Commission's current approach to price regulation is to monitor trends in the prices of Essential Maritime Services (EMS) over time against changes in the CPI. Where a service provider increases prices by more than the CPI, the Commission will request justification for doing so.

It is our view that this methodology is flawed as it provides no incentive for service providers to increase efficiency and reduce prices. It is reasonable to expect that a privately owned, profit maximising firm that enjoys market power will increase its prices if permitted by the regulator. By explicitly examining prices with reference to the CPI, the Commission provides no incentive for regulated service providers to maintain or reduce prices. Why would a firm seek to increase its efficiency when it knows it can simply increase its prices instead?

Given that one of the Commission's objectives, under Section 6 of the *Essential Services Commission Act 2002* (SA), is to protect the long term interest of South Australians, it is interesting that the Commission has not opted for a CPI-x type criterion instead of price monitoring. The Commission has considerable discretion under Section 25 of the Act regarding the form of price regulation. CPI-x regulation, whilst admittedly being more burdensome to comply with, could potentially promote efficiency and put downward pressure on prices. Why is it, that if one of the arguments for privatisation of natural monopoly industries is increased efficiency, that more of the benefits are not flowing on to port users? Is it not reasonable to expect that a port corporation like Flinders Ports, which has been privatised since 2001, could reduce prices over time as it removed the inefficiencies that existed when the corporation was under public ownership?

2. Market Power

Based on Flinders Ports Pty Ltd financial reports and other data between 2006-07 and 2010-11, there is evidence to suggest that Flinders Ports have exploited its market power to some degree. This is based on a number of points, bearing in mind the aggregate nature of the data:

- The benchmarking undertaken by Meyrick and Associates found that prices at Flinders Ports were generally higher than interstate ports;
- The company's financial reports suggest that they are consistently profitable (although not excessively so);
- On average, Flinders Ports enjoyed a greater return on assets than the ports of Melbourne and Fremantle;
- On average, Flinders Ports' profit per tonne of cargo was higher in real terms than the ports of Melbourne and Fremantle, although not markedly so; and
- Flinders Ports' dividend payout ratio was greater than 100 per cent of its after tax profits for four of the five years, indicating that a significant proportion of the producer surplus is not being ploughed back into its ports to benefit users.

In our view, the weight of the evidence above suggests a different conclusion than that drawn by the Commission. It has been suggested that the possibility of more prescriptive regulation

would act as a deterrent to the misuse of market power.¹ This threat is not credible if price increases are reviewed only where they exceed the CPI. Therefore, it is argued that the current price regulation framework has possibly failed to deter the exploitation of market power and certainly failed to ensure maximum benefits for port users.

Is there a net benefit associated with retaining price regulation (of any form) for the ports price regime?

It is our view that there is a net benefit to maintaining regulation, and perhaps increasing the level of regulation. South Australian ports, like other ports, exhibit characteristics of natural monopoly. This means that it is more efficient for a single firm to exist, rather than many, as the case would be in a competitive industry. The existence of natural monopolies does not in itself necessitate regulation. Many jurisdictions in Australia have no independent price regulation of port services.² Regulation arguably becomes more important, perhaps indispensable, when a natural monopoly is privately owned.

South Australian ports face little competition, owing to their natural monopoly status and geographical isolation. Regulated service providers will continue to enjoy market power, and there exists potential for the misuse of that market power. Regulation can help keep providers of EMS in check, protecting port users from potentially facing monopoly like prices. As noted by the Commission, these benefits must be weighed up against the cost of complying with regulation. Price monitoring has minimal compliance costs. It is noted that more prescriptive regulation will potentially increase this burden, which will likely be passed on to port users in the form of higher prices. It is also noted that information asymmetry increases with the level of regulatory intervention. Despite this, it is argued that the benefit of regulation to port users and South Australians outweighs its costs. Price regulation therefore should continue and arguably be extended to CPI-x regulation, for a further regulatory period.

¹ ESCOSA, 2007 Ports Pricing and Access Review, Final Report, p18, September 2007.

² Western Australia, Northern Territory, Tasmania, Queensland and New South Wales. It is noted that the various independent bodies in WA, NSW and QLD can potentially have such a role in the future following a declaration by the relevant Minister.