

## **Transport Deregulation in Australia: An Interpretation in Terms of Public Interest and Private Interest Theories**

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### Abstract:

In the Australian transport sector, deregulation has been taking place for some time, though not for all industries. In this paper, the deregulatory experience is analysed in the light of contrasting rationales – the public interest and the private interest approaches. Information about the costs of regulation has improved, and the pattern of gains and losses experienced as a result of it have altered. As conditions change, regulation tends to impose greater efficiency costs. The private interest rationale appears to fit past changes better. This has implications for the future, suggesting that further deregulation may be modest.

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### Why transport deregulation?

Why have many of the transport markets in Australia been extensively deregulated over the past couple of decades or so? While deregulation is by no means complete, (there is substantially less regulation now than there was in 1970 in such markets as international and domestic aviation, intrastate freight, and to a lesser extent intrastate passenger transport. Some markets, such as shipping and urban transport, have experienced relatively little change.) The differing experiences of these markets provides a useful set of cases with which to test the alternative theories of why markets are regulated or deregulated.

Initially, economists took a 'public' interest approach to explaining regulation - regulation was present to lessen distortions present because of market failure. Where there is a natural monopoly, e.g. with gas reticulation, regulation through price controls would seem to fit the public interest interpretation. For much of transport, natural monopoly is either not present, or is of relatively small significance. In Australia, the dominant form of regulation has consisted of restrictions on entry, and in some cases, limits on the capacity that may be supplied. In short, it has created market power rather than lessened it. Such regulation is more difficult to rationalise in public interest terms.

The difficulties of rationalising the observed effects of much regulation with the public interest led to an alternative, the 'private interest' or 'Economic' theory of regulation. (See Stigler, 1971, Posner, 1974, Pelzman, 1976). This theory posits that regulation is the result of governments balancing opposing private interests to maximise political support. Various groups of consumers, firms and unions will demand different regulatory structures for a market, and the outcome will depend on the political strengths of these groups. Producers are often well organised and coherent, as compared to consumers who tend to be dispersed and they will want restrictions on competition and through this, higher prices. This theory has been very successful in providing an interpretation of regulation in the U.S. and other countries. It has been applied in Australia, for example, to domestic airline regulation (Kirby 1981) and transport regulation in general (Forsyth 1982). Its very success raises a problem - if it is so successful in explaining regulation, how can the move towards deregulation, in the U.S. (see Keeler, 1984), Australia and elsewhere be explained?

The move towards deregulation may imply that this theory is no longer applicable (and perhaps, never was). However, this need not follow. Conditions, such as demand, costs and technology change, and the balance of private interests shifts. It is possible that these have been shifting towards deregulation. Pelzman (1989) examines the U.S. regulatory changes, and concludes that most, though not all, are consistent with the 'economic theory'. In Australia, Harper (1986) has interpreted financial deregulation in these terms.

In this paper, the moves towards deregulation or less regulation in transport markets in Australia are examined in terms of their possible rationales. It is concluded that the changes taking place have been very consistent with the private interest or economic rationale. In some cases, deregulation can be partly

interpreted in terms of the public interest rationale, though its explanatory power is a good deal less than that of the economic theory. In this paper, the regulatory changes to transport are first surveyed, and then what is meant by 'deregulation' is discussed. The possible rationales for change, and how they might apply in general, are discussed, and then they are examined in the context of individual transport markets. Finally, some conclusions are drawn from the analysis.

### **Transport deregulation in Australia**

Significant regulatory changes have been taking place in Australia since the mid 1950s, though they have not all been in the same direction. Interstate road freight was deregulated in the 1950s, but soon after, domestic aviation was regulated. Since around the mid 1970s, most changes have been in the direction of less regulation. Both the Federal and State governments have been involved in transport regulation and subsequently, deregulation. Changes have taken place on an ad-hoc basis, and it cannot be said that there has been any sharp policy shift towards deregulated markets on the part of governments. They are more willing to accept with deregulated markets now than in 1970, and deregulation forms one of the mechanisms being relied upon as part of the Federal government's push for "Microeconomic Reform". However, as international aviation and urban transport indicate, governments are not following a policy of imposing deregulation on all markets.

The patterns of regulatory change are summarised in Table 1. Australia deregulated freight comparatively early. Interstate road freight was deregulated in 1954 as a result of a court case in which it was held that regulation of interstate freight was unconstitutional. Governments attempted to get round this ruling, but they were not successful (see Kolsen, 1968 Ch.9 and Joy, 1964). They were, however, able to continue to regulate intrastate transport. Regulation meant that road transport was taxed, and in some states, such as NSW, most of the proceeds were given to the railways. Gradually, the states deregulated intrastate general freight, completing the process around 1980. Restrictions on carriage of specific freights, such as grains, have remained for longer, though many of these are being removed currently. There has been very little regulation of urban freight (see Hicks, 1977 for a discussion of this market).

Governments have been slower to deregulate aviation. In the 1950s, there was a moderately deregulated domestic aviation system, but, largely at the insistence of the major private airline, the government instituted the Two Airline Policy in the late 1950s and early 1960s. The key aspects of this policy were a prohibition on entry and price controls. This regulation remained in force with little change until 1990, when there was an extensive deregulation. It was not complete deregulation, since international airlines serving Australia (including Qantas) were prohibited from entering domestic markets, and prior to deregulation, most terminals at major airports were assigned on long leases to

Table 1

Patterns of Regulatory Change

<u>Market</u>	<u>Timing</u>	<u>Extent of Reform</u>	<u>Comments</u>
Interstate Freight	1954	Thorough	Result of Constitutional Challenge
Intrastate Freight	to 1980	Thorough	Differed considerably by State
Urban Freight			Little Economic Regulation
International Aviation	1970s	Partial	Differs by Routes
Domestic Interstate Aviation	1990	Moderately Thorough	Restrictions Remain - Terminals
Domestic Intrastate Aviation	1980s	Varies	Some States Thorough (SA) others Little Change
Long Distance Passenger	1980s	Varies	Differs by States, routes
Urban Passenger Transport		Very little	
International Shipping			Little Economic Regulation. Subsidies to Australian Suppliers
Coastal Shipping	Late 1980s	Little Change	Threat of Competition Used.
Ports		Little Change	Direct Pressure to reduce costs.

the two major domestic airlines. (For details, see Trade Practices Commis. 1992). Restrictions on entry by international airlines based in Australia and New Zealand are proposed to be dropped as part of the formation of an Australia-New Zealand aviation market. Apart from this, there has been little deregulation of international aviation since 1980. In the early 1970s there was pressure from airlines based in South East Asia to be allowed to serve Australia-Europe markets. These airlines were able to offer substantially lower fares, and pressure from consumers forced the government to allow some competition from these airlines (see Findlay, 1985). There has been some liberalisation of the Pacific market, largely at US insistence. The Asian airlines are still capacity controlled, and many markets, especially those to North Asia, are still tightly regulated. Australia operates a relatively restrictive international aviation policy, and there has been little change to it since around 1980. Intrastate aviation is controlled by the states. Western Australia operates a policy of limited competition, NSW a franchised monopoly system, but South Australia and Victoria deregulated their aviation in 1979 (Crowley and Findlay, 1990).

The State governments have long regulated urban passenger transport. They own authorities which provide rail, bus, tram and ferry services in the major cities. Private buses are usually permitted, but they are allocated routes which do not compete with the public providers (mainly in outer suburban areas). Routes are allocated on a franchise basis, and fares are regulated. Taxi licensing exists for capital cities and smaller regional centres, and fares are also regulated. There have been few regulatory changes in the post war period, and much of the interest at present is in contracting out by the public providers, rather than in permitting competition.

Shipping is not regulated in the same way as other markets. International shipping is not regulated, but Australian participation in this market has been encouraged through subsidies. Coastal shipping is open to competition from Australian firms, though it is not open to foreign firms. Within the market, regulation at the product market level is not significant, though there is extensive regulation of the labour market, and this has impacts on costs. The government has wished to reduce coastal shipping charges, and to do this it has sought to reform labour markets (Dick, 1992 forthcoming). It has been able to use the implicit threat of opening markets up to cheaper foreign shipping as a lever to induce reform. It has had some success in this regard. With ports, the threat of foreign competition is not present, though the government is negotiating a labour reduction scheme. In the longer term it is trying to promote inter-port competition by improving land transport.

### **Deregulation and its effects**

Thus far, little has been said about what deregulation is taken to mean, and what its effects have been or are expected to be. For purposes here, the key aspect of deregulation is the removal of entry and capacity controls; for example the

removal of the entry prohibition in domestic aviation, or on operating specified intra-state bus routes. It is this aspect of regulation that has been most important as a means of creating market power for the producers.

Others forms of regulation have been significant. The closest in terms of effects, to entry or capacity controls was the system of road freight 'licences'. This was really a form of taxation, of one mode to protect another - to operate a road freight journey, the provider had to purchase a 'licence'. This raised the cost of road freight, and made it less competitive with rail. Entry restrictions could have had the same effect, but the revenue would accrue to the road operators, not the government.

Price controls have been used in many cases, such as airlines and buses. There are few examples of traditional natural monopoly in transport which might give rise to a case for price control. Rather, price controls are introduced because monopoly has been created, through entry restrictions. When these are removed, the case for price control weakens or disappears - thus, when domestic aviation was opened up, price controls were ended. Apart from these forms of economic regulation, transport markets are regulated in other ways - for example through safety and environmental controls. These have not been removed when markets have been deregulated - in some cases they have been tightened.

Thus, by "deregulation" is meant here the policy of permitting additional (possibly unlimited) competition in product markets. In some markets (long distance passenger transport) there has been a move towards contracting out. This enables competition for the right to produce the service, though it does not result in additional competition at the product market level. As such, its effects will be somewhat different, though it is, along with deregulation, being used as a means of improving efficiency. As will emerge in later discussion, it is being used as a substitute for deregulation.

Regulation (i.e. restriction of supply) has several effects, which deregulation can reverse. It results in higher prices, and creates by a transfer from users to producers. These transfers can be used in several ways. Firstly they can result in higher profits. Secondly, they can result in higher factor payments, such as wages. Thirdly, they can be wasted, through slack and excessive use of inputs. Deregulation should result in gains to users at the expense of losses to the owners of the firm and the people they employ. However, the gains may well outweigh the losses, because efficiency can be improved.

These efficiency gains can have three main sources. Firstly, a more competitive environment will put pressure on producers to lower costs through improving productive efficiency. Secondly, the more flexible environment will tend to result in a better product-mix being offered; regulation tends to weaken incentives for firms to seek out all possible markets. Thirdly, another source of allocative efficiency gains comes from firms being forced to lower prices, and set them closer to (marginal) cost, leading to an efficient level of the service being provided (for example, leading to an efficient mix between road and rail freight).

The actual effects depend on how strong competition is in the deregulated

market. If deregulation results in a strongly competitive market, as it has with road passenger transport, the users would be unambiguous gainers, and the producers (including providers of substitute services such as railways) would almost certainly lose (they would not lose in the - virtually impossible - situation where price controls keep prices at minimum feasible levels). However, strong competition may not eventuate in the deregulated market. There could be no more firms than before, and while these are likely to compete more aggressively between themselves than before, they may have more scope to raise prices than under regulation, if price controls were imposed. This could be the case with domestic aviation.

Evidence suggests that the airline market is not likely to have many firms (see Forsyth, 1989) and it is not likely to be very contestable either (e.g. see Morrison and Winston, 1987). Thus there is a possibility that deregulation can lead to overall efficiency gains (through increased productive efficiency), but a transfer from users to producers. Another, perfectly plausible scenario, is that both groups gain; this would occur if cost reductions enable profits to increase even when prices are reduced.

### **Rationales for deregulation**

There can be no doubt that deregulation and privatisation are fashionable. They are two policies which have attracted the attention of governments across the world, which have been under pressure to improve the economic performance of the various industries that make up the economy. Just as, after the Great Depression, coordination and regulation were seen as welfare improving, now regulation is seen as excessive, and deregulation is regarded as a "good thing". Underlying this, there are real economic forces moving governments towards deregulation. A possible public interest rationale stems from greater information about the effects and costs of regulation being available. However, the balance of private interests is also changing.

### **The Costs of Regulation**

One view of the move towards deregulation is that public interested governments have become better informed about the costs of regulation, and have sought to maximise overall welfare by deregulating markets. Until recently, the costs of regulation were not well understood, and the view that regulation was present to mitigate market failure was probably widespread. Economists often noted that reducing competition was not the way to encourage efficiency, but faith in the ability of governments to pursue the public interest was strong, and the awkward observations were taken as the exception rather than the rule. The development of the economic theory of regulation has itself induced a more critical perception of regulation.

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In Australia, as in the U.S., the costs of regulation have been documented. The effects on efficiency of freight regulations were examined by Kolsen (1968, 1973); this was the first regulated market in Australia to be analysed critically. Most deregulation of intrastate freight came after economists had questioned regulation, though interstate deregulation, which occurred when it did because of a constitutional ruling, preceded it.

The most thorough examination of regulatory costs has been done for aviation, mainly by academic economists. The costs of the Two Airline Policy were documented (Mackay, 1979, Gannon, 1979, Hocking 1979, Hocking and Forsyth 1980 and Kirby 1979), and following this lead, official inquiries became critical of the Policy (Independent Public Inquiry into Domestic Air Fares, 1981), Independent Review of Economic Regulation of Domestic Aviation, 1986, as were government research institutes, such as the (then) Bureau of Transport Economics (B.T.E., 1985). The economic analysis of U.S. airline regulation and the early experiences of deregulation along with the analysis of international regulation (Findlay, 1985) were all important in forming perceptions of the cost of regulation. By 1987 the government had decided to end the Two Airline Policy. It is possible that the mounting evidence of its inefficiencies had some impact on the decision - economists do like to think that their marginal product is not always zero. It has been suggested that economic analysis has affected the process of deregulation in the US (see Noll, 1989).

By the late 1980s, the performance of the transport industries was being subjected to a good deal of scrutiny, now mainly by government research bodies such as the Bureau of Transport and Communications Economics and the Industry Commission. Efficiency losses in road freight, bulk handling, rail, airlines and shipping were assessed and put into context (Industry Commission, 1990 and also Forsyth, 1992). This and further work suggests that they can be large. The assessments being done are provided to governments, and are being considered as policy is developed.

The view that better information has demonstrated the effects of regulation, and induced governments to seek to increase overall welfare by deregulation is consistent with the facts of some cases, especially that of domestic airline deregulation. But it is also possible that governments have simply used the available analysis to support what they had already decided to do. Further, in some cases, the potential gains from deregulation have been documented, yet governments have not been willing to act (international aviation). Stronger evidence of the public interest rationale would be present if it could be documented that the government took a difficult decision to deregulate an industry against the strong opposition of interested parties, such as producers. To test a theory, it is necessary to examine alternative explanations.

The changing balance of private interests

An alternative view is that governments have been deregulating in order to

achieve a better (i.e. more politically profitable) balance of private interests. There has been little in the way of additional regulation since around 1960 - most of the change has been in the deregulatory direction. However, there has been little regulatory change in some markets, such as urban transport. If this view is to hold, it must be shown that the balance of gains and losses from regulation have been changing

The role of information and analysis was highlighted above. Better information is consistent also with the private interest rationale. The losers from regulation - who are typically more dispersed and less organised - would have a better idea of the losses they are incurring, and they may put more pressure on governments to deregulate. Over the 1980s, as more information about airfares in Australia and elsewhere became available, consumer dissatisfaction with the Two Airline Policy grew. Better information also makes governments more aware of costs and benefits to different groups, and alerts them to the political gains they could achieve through changing the balance. However, better information and clearer perceptions are not the full explanation.

[There are several ways in which the cost of regulation can change, and the size of the gains and losses can alter.]

(a) Demand Patterns Change. Regulation locks producers into specific products, through restricting the incentive and ability to change as demand shifts. For example, airlines supply convenient, but high cost services when what a large segment of the market wants is cheap, although restrictive, fares.

(b) Prices become out of line with minimum possible costs. While regulated firms may charge prices equal to actual (average or marginal) costs, inefficiency may build up, and prices are higher than they need be. The cost to consumers of regulation rises, even though producers do not benefit.

(c) Relative Costs of Substitutes change. Over time, the relative costs of substitute products change. If the product becoming cheaper is denied or restricted to users, the cost of regulation to users rises. This happens if road freight becomes cheap relative to rail, but regulation limits access to road.

(d) General technological change. Technological change makes new products possible, alters relative costs, and alters the most cost effective way of producing things. Regulation can simply break down, as users find ways around it.

Thus, over time, two related processes can occur (i) The relative gains and losses from regulation can change, and (ii) the total cost of regulation can change; and most likely increase. If either of these occurs, deregulation can be explained in terms of altering private interests, though the second would also be consistent with a public interest explanation

If there is no change in the overall cost of regulation, but the balance of gains and losses shifts, the government may be pressured to deregulate (or, at least take action to lessen the redistribution). An example might be where a set number of taxis are licensed for a city. Over time, demand grows, prices rise and profits increase. The gain to licence owners is slightly less than the loss to users (until the distortion cost becomes large through price being well above marginal cost). The political costs are unlikely to be linear in the economic

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losses of the users - they are likely to increase more than proportionately (at some stage, high taxi fares and profits become a scandal) and the government is forced to deregulate or partially deregulate, through creating more licences. Deregulation acts as a circuit-breaker.

When the overall cost of regulation rises, the pressure on the government to deregulate will become even stronger, since the political costs will be growing faster than the political benefits of regulation. It is possible for the costs of regulation to rise, fall or stay constant. However, the most likely case is that they will rise.

This is so for the following reason. When an industry is first regulated, the regulation is imposed on what is basically a market solution. Existing producers in the industry will get licences to produce. Prices initially will be close to the market prices - they may be regulated this way. Producers do not gain much, nor do consumers lose much. However, over time, the parameters (licences, prices) that were originally set become inappropriate as demand, costs and technology change. Prices will not fall relative to cost (firms would exit), though they can rise, especially compared to possible minimum costs. Regulation which originally imposed only small efficiency costs, and created small gains and losses, gradually imposes larger efficiency costs, and entails larger gains and losses. At some point, the losses to some groups, or overall costs, become too large, and partial or total deregulation is forced on the government. According to this approach, any regulatory structure has only a finite lifespan. Regulation snap-freezes a market at a point in time - but eventually the use-by date comes around.

This also suggests that a cyclical pattern of regulation and deregulation could eventuate. Regulation becomes inappropriate and the market is deregulated. After a time, some producers experience difficulties, and prevail upon the government to introduce minor new regulations, which give them a little protection from competition (especially new firms entering). Eventually, the costs of the new regulations mount up, and there is pressure for deregulation. There are some cases of this cyclical process, such as US airline deregulation. In the 1950s, airlines were partially deregulated for a time - this enabled a realignment of fares and product mixes (e.g. introduction of coach fares). After a period of adjustment, regulation was re-imposed (Cherington, 1958).

Governments may be convinced that there is a case on public interest grounds for regulatory reform in an industry. If such reform imposes losses on strong private interests, they may be unwilling to act. However, they might be able to shift these losses to more dispersed groups, such as taxpayers, by compensating the losers. By so doing, they can lessen, though not eliminate, the political costs of reform. Private interests need not form a binding constraint on reform; such reform will be more likely if the losses fall on, or can be redistributed to, groups which are politically weak. Such a redistribution will normally lessen the net gains from reform because such shifting of the losses is itself costly in efficiency terms.

### **Deregulation in specific markets**

The differing rationales noted above can best be tested by looking at the experiences of specific markets. These are considered in turn.

#### **International aviation**

There was a partial deregulation of some international aviation markets (routes) over the 1970s. On the routes to Europe, competition, on a restricted basis, from low cost Asian airlines was permitted. In addition, there was more limited liberalisation on other routes, such as to the U.S. The pressure for deregulation came from consumers, who perceived that air fares were high than they needed to be. This had come about through changing relative costs. Initially, the Australian and European airlines were the only firms capable of supplying the service. Then Asian airlines developed, and were capable of producing the service at significantly lower cost. The government allowed these airlines access to the market, but kept capacity controls so that the Australian airline, Qantas, and European airlines were still able to compete. Air fares did not fall as low as they could have. This is a good example of the balance between producer and consumer interests altering and partial deregulation establishing a new balance. In this case, producer interests were against change. (For more detail, see International Civil Aviation Policy Review Committee, 1978, Findlay, 1985, Dwyer and Forsyth, 1992 forthcoming).

Partial deregulation did not result in all efficiency gains being achieved - further gains are possible if routes are opened to more competition, especially from Asian airlines. Several routes remain quite restricted, and prices on them are high. This is partly because of other countries' policies. Since 1980, there has been a tourism boom to Australia, and much of the growth in airline demand is from tourists travelling to Australia, rather than Australians travelling abroad. This has altered the proportions of domestic and foreign consumers. There is some pressure, mainly from the tourism industry, for more liberal arrangements, though there has been little change in regulation (except to allow multiple designation of Australian airlines on capacity controlled routes and to create an Australia-New Zealand market). The reluctance to deregulate further can be explained in both public and private interest terms. Firstly it is less clear these days that low fares are in Australia's interest - if a tourist saves \$100, Australia may gain if more tourists come, but the gain is unlikely to be as great if \$100 accrues to a resident. However, the public interest explanation would be more plausible if there had been more deregulation before the unexpected tourism boom, when most of the gains would have accrued to Australian tourists. Secondly, the pressure for fare reductions is likely to be less than if traveller/voters gain rather than the tourist industry. The international market provides a good example of the costs of regulation growing, and partial

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deregulation reducing these costs.

#### Domestic aviation

When the Two Airline Policy was established, it probably did not create many costs. Air fares did not rise, and airlines did not immediately make significantly higher profits, but their profitability was guaranteed. Over time, potential costs fell, but actual costs and fares did not, and consumers became aware that fares were higher than they might have been. Airlines were business traveller oriented, and less interested in serving tourism markets. U.S. experience suggested that major airlines were able to survive and prosper under deregulation, and this message was not lost on the airlines. When the government announced deregulation, it was popular amongst consumers, and, by then, airlines were not opposed to it. Unions, representing the main potential losers, were not as opposed as they might have been. The government had been unwilling to deregulate when the airlines opposed it, even though a public interest case had been established; it only deregulated when there was little opposition.

#### Long distance freight

Freight regulation has typically involved taxation of road to protect rail. Entry into the industry was easy, and it has generally been regarded as competitive and efficient. Removal of regulation was mainly in the interest of users, and to a limited extent road hauliers, and against the interests of railways, their employees, and owners, the governments. The cost of regulation grew - at one stage it nearly doubled the cost of road freight (Kolsen, 1968, p.133) - as road costs fell relative to rail costs. The benefits to the producers - protection - did not grow in proportion, since the benefits from having the railways carrying freight for which they are not suited are limited. To an extent, protection enabled the railways to practise cross subsidisation. The start of deregulation was occasioned by a court ruling, though this is likely to have advanced the timing of deregulation rather than caused it. The removal of interstate regulation made intrastate regulation more difficult, because intrastate trips were diverted to include interstate components ("border hopping"). Significantly, the most remote state, Western Australia, was one of the last to deregulate. Since deregulation, governments have allowed their railways to maintain output and employment to an extent, by financing rail deficits; thus taxpayers financed part of the road freight price reductions. This suggests that both producer and user interests were strong, and the resolution was to meet both their interests at some cost to taxpayers. This is more consistent with a private than a public interest rationale; the public interest would have been to allow rail output to fall further

### Long distance passenger transport

There has been some gradual liberalisation of non-urban passenger markets, though another important development has been the growth of contracting out. Interstate passenger transport was deregulated at the same time as interstate freight, though intrastate regulation remained. Entry and capacity controls were used to protect rail services (BTE, 1985b). As with freight, the relative cost of road fell over time, making this regulation expensive. The prevalence of the private car drained passengers from rail, which was unable to maintain service levels. The maintenance of rail's output was becoming very costly. Pressure for change came more from this source than from passengers, though coach operators were interested in serving intrastate markets. In some cases, markets were simply deregulated (Sydney to North Coast NSW in 1987). The more common response has been for rail to maintain its near monopoly by contracting out services to coach operators. This reduces costs for the railways, gives coach operators access to business, and results in the maintenance of services. In many cases routes are operated at a loss, and the railways cross-subsidise to maintain services to communities. With passenger transport, governments have acted to reduce the cost of regulation and protection, which they themselves were paying, by adopting a mechanism (contracting out) which was more acceptable to producers (ie. rail) interests than the alternative, deregulation. There does not seem to be a public interest motive for preserving the rail monopoly, especially when coach services to small communities can be subsidised directly if need be.

### Shipping and ports

This is an area where there has been little shift in the costs of the arrangements, and where there has been little change in the balance of forces. There have also been few regulatory changes, even though there are well established inefficiencies present; on public interest grounds there is a strong case for liberalisation. The government is aware of the inefficiencies, and has been using the implicit threat of liberalising coastal shipping to force efficiency gains in this market. It has been attempting to gain port efficiency gains, and has had some moderate success (Workers have been compensated for job losses). Shipping provides an example of the government attempting to pursue the public interest, but in a way which does minimum harm to private interests (though at some cost to taxpayers).

### Urban transport

There has been little change in urban transport regulation - it is possible that changes will be made, though this remains to be seen. The regulatory structure is in the interest of railways and public buses which are protected from

competition from private buses, but it is also in the interest of bus operator (limited competition, guaranteed incomes) and taxi licence owners. The costs of this regulatory structure have probably not changed by very much over the years, and the balance of interest has not changed significantly. With taxis, as the balance between interests alters, e.g. through demand increases causing a rise in the value of a taxi licence, governments restore the balance by issuing more licences. New technologies (e.g. dial-a-bus) may yet put pressure on regulation. The costs of the system are becoming better understood, especially the higher cost of public than private buses (Hensher, 1987).

The changes that are being considered fit more into the category of contracting out rather than deregulation. This will result in more efficient production of services, though it will not improve the product mix being offered (e.g. the bus routes available, dial-a-ride services), or the pricing policies (greater distinctions between peak and off peak prices). It will be consistent with maintaining the cross-subsidies that are in place. Contracting out will lead to improvements especially in terms of productive efficiency, but it will remove fewer inefficiencies than deregulation. It will, however, be more acceptable to producer interests.

#### **An assessment of transport deregulation**

Views on the costs and benefits of regulation have changed, and it is possible to view the trend towards deregulation as reflecting the desire of governments to advance the public interest. However, both the pace at which it has been occurring, and the ways in which it is being achieved point to the importance of private interests. Private interests have sometimes been the motive force for change; at other times they have been constraints on governments pursuing public interest objectives.

There are several examples of deregulation in Australian transport, though there remain markets which have been subject to little regulatory change. In most of the markets where there has been deregulation, there have been rises in the overall cost of regulation, and changes in the balance of the gains and losses that different parties experience from regulation. Regulation freezes conditions in markets, and over time these become more and more out of line with consumer preferences, costs and technological opportunities. The additional costs to users of the products outweigh any extra gains that accrue to producers. The pressures on governments then change, and they are pushed towards partial or total deregulation. This happened with aviation and freight. Usually, producers were not in favour of deregulation, though in the domestic aviation cases, one of more or less complete deregulation over a short period of time, they were mildly in favour. Where there has been less change in private interest, deregulation has been less often used, or less thorough. This is especially true of shipping and urban transport.

One trend that is becoming evident is the use of contracting out as a way

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of lessening the costs (especially to the producer, often owned by the government) of regulation. Contracting out is a change which is less extensive than deregulation, since it is able to address only the productive inefficiencies, not the allocative inefficiencies that develop under regulation. It is a reform which imposes less costs on the producers, rail or urban bus authorities for example, who still keep control over the product, and who do not risk being displaced by competition. It is an attractive option to governments worried about the costs of financing losses made by their transport authorities. Its use has lessened the pressure for deregulation, in such areas as intrastate and urban passenger transport.

Many of the changes that have been made are consistent with either a public or a private interest rationale. For example, partial deregulation of international aviation could be explained in terms of either of these. In some cases, governments have not been forced to act, but they have chosen to seek efficiency improvements in the face of opposition - for example in coastal shipping and ports. This tends to support a public interest rationale. However these cases are rare, and in the two mentioned, the case for reform has long been established, but governments have been slow to act, and they have not pursued thorough reform. In several cases, especially with urban transport, the gains from reform have been long established, but governments have not acted. This is also true of international aviation, where change after the partial deregulation of the 1970s has been modest. The timing of domestic airline regulation, after the government had won the airlines' acceptance of it, is another pointer to the private interest rationale.

In the light of this, the private interest rationale seems more consistent with the experiences than the public interest rationale. Given the nature of most transport regulation, restrictions on competition which help producers at the expense of users, at some cost in terms of efficiency, and given that, at least for several markets the cost of regulation has been growing as conditions have changed, if public interests were dominant, we would expect to have seen much more change. Instead, changes have usually taken place only when strong pressure has been placed on governments, or when little opposition has been present. The private interest motive is consistent with the gradualness of reform, its often partial nature, and the types of reform that have been chosen. It is also consistent with the emphasis on shifting the costs of reform away from producers and on to more dispersed groups, such as taxpayers, at some cost. Both rationales are consistent with deregulation, though the private interest rationale more so with the patterns that have been observed.

The assessment of the role played by alternative rationales of deregulation is not of interest simply as a matter of interpreting history. It can shed light on what is likely to happen in the future. If it is public interest that motivates governments, considerably more deregulation is likely, since the efficiency case against some forms of regulation (taxis, international aviation) is strong. Alternatively, if private interests dominate, such deregulation must be regarded as much less likely, since it will impose a cost on strong private

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interests. There will also be more attention paid towards compensating losers, and thereby shifting the burden of reform on to those less likely to oppose it. As conditions change, the balance of interest change, and further deregulation may come about, though the process will be slow (indeed, more regulation is a possible option). However, if private interest dominate public interests, future moves in the direction of deregulation are likely to be slower in coming, and less thorough going.

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