

# Inquiry into Privatisation of Regional Infrastructure and Government Business Enterprises

An IPA Submission to the House of Representatives Standing Committee on  
Transport and Regional Services

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# **House of Representatives Standing Committee on Transport and Regional Services**

## **Inquiry into Privatisation of Regional Infrastructure and Government Business Enterprises (GBEs)**

### ***Summary***

Over the past decade, the electricity and gas industries have seen considerable improvements in efficiency with lower prices and increased reliability. These improvements have been evident both in the urban and rural areas.

While some rural areas have seen lower employment levels as a result of increased efficiency in the energy supply industries, the higher levels of employment in the industries under their integrated state monopoly structures were not sustainable and presented an unsound basis for prosperity. In any case, the strained financial circumstances in which State Governments found themselves by the early 1990s were already bringing major cuts to GBE employment levels.

Deregulation and privatisation have been the means by which the improvements to prices, reliability and efficiency have been brought about. Deregulation has involved disaggregating formerly integrated supply industries so that different segments of the supply chain are no longer affiliated and, where possible, competition is introduced within the different segments. In general, this process accompanied by privatisation has resulted in a superior outcome than when supply businesses have been left under public ownership. This reflects the inherently stronger incentive structures in private as opposed to public ownership.

Privatisation also relieves governments from the potential conflict of interest they have as an asset owner and as the law maker and upholder which creates the environment within which private and public enterprises operate. That conflict of interest, the elimination of which was a major goal of national competition policy, can reduce the confidence of the private sector that a level playing field is in place and lead to investment uncertainty.

Finally, some deficiencies of the system are evident where the deregulation has not gone far enough. Important in this respect is the ever-present danger that regulatory authorities will fail to achieve their objective of replicating a market outcome. Regulatory authorities are prone to capture by populist interests and to set prices below their appropriate levels<sup>1</sup>.

Like other organisations, regulatory agencies also resist vacating an opportunity to regulate and find rationales to remain exercising control even when, as with most of gas transmission, competition offers adequate restraints on major suppliers. Under such circumstances retaining regulatory control is likely to bring inefficiencies.

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<sup>1</sup> Regulatory arrangements may also place an undue priority on risk avoidance and therefore place upward pressure on contract prices, a feature of the regulated prices in South Australia which rose 25 per cent in 2003.

# House of Representatives Standing Committee on Transport and Regional Services

## Inquiry into Privatisation of Regional Infrastructure and Government Business Enterprises

### ***Impetus to Australian Infrastructure Reform***

Reforms in Australia were spurred by three different but associated factors:

- seeking improved management efficiency,
- neutrality in the dealings of state enterprises with other parties, and
- privatisation of assets both to better meet these goals and to relieve budgetary pressures.

It was in fact the Hawke Labor Government that, initially in the mid-1980s, first embarked on some rather tepid movements in the direction of deregulation. These progressively became more serious, especially in the early 1990s following a report on competition policy chaired by businessman/academic Fred Hilmer.

As well as attempting to dismantle layers of government restraint of business, deregulation had three other dimensions:

- placing government business entities on a footing similar to private businesses and at arms length from the political process;
- ensuring “open access” by users of and suppliers to natural monopoly facilities like electricity lines and rail tracks; and
- terminating as the exclusive preserve of government entities, certain activities including infrastructural facilities.

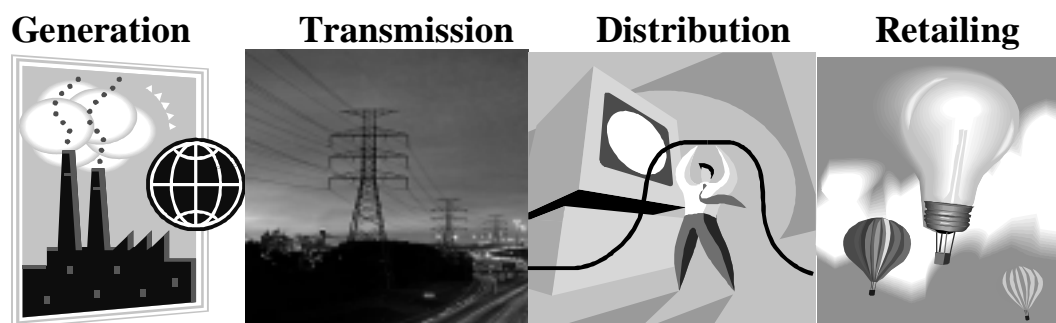
All three of these competition enhancing policy dimensions were predicated on the premise that the outcome would be lower cost supply and a better matching of the products consumers want with those producers provide. These expectations of improved outcomes have been amply born out in the gas and electricity supply industries

### ***Competition Policy and the Electricity and Gas Industries***

The National Competition Policy operates in two broad fronts:

- the review of laws that restrict competition; and
- a national access regime and price controls over “essential facilities”.

The basis of the Australian reforms and privatisations, in line with those in other jurisdictions, was a disaggregation of the previous monopoly over electricity supply into generation, long distance transmission, local distribution and retailing.



In the case of gas, production (the equivalent of generation) was always independently owned. A long standing concern, albeit one that is receding somewhat, was with the concentration of production resources. The New South Wales, Victorian and South Australian markets each were served by a monopoly gas source. Efforts were made by the ACCC to force a competitive supply by requiring the different joint venture partners in Bass Strait and the Cooper Basin to market separately. This would however have required the abrogation of contracts.

Electricity disaggregation was planned in Victoria concurrently with the privatisation but other states also embarked on a disaggregation of the industry. Disaggregation in Australia, leveraging off the mistakes made in the UK, was conscious of the need to maximize the role of competition to provide the discipline for the promotion of efficiency and to prevent price gouging.

In Victoria and South Australia, generation was disaggregated to the maximum extent practicable—essentially into seven separate Victorian suppliers and five in South Australia. Queensland was similarly comprehensive but the NSW Government was unable to divide its generation units among more than three businesses due to trade union opposition. Even in NSW this has proven to be generally adequate to ensure a competitive price, especially since there is additional rivalry from the Snowy/Victoria and latterly from Queensland.

It was intended for generation and retailing to operate in a totally deregulated market with distribution and transmission, which were viewed as “essential facilities” or natural monopolies, to be regulated.

At the onset, generation, transmission and distribution/retailing were to be structurally separated but there were no specific long-term measures to prevent re-aggregation.

Although retailing and distribution were sold as combined units, they were to be “ring fenced” to prevent the distribution business favouring its affiliate. In the event all five of the original Victorian host distribution business/retailers now have separate companies handling the two activities.

Retail was a part of the electricity industry envisaged as being contestable and requiring no more regulation than is required of other retail activities. In fact, although commercial supply is now largely deregulated, governments have been cautious about deregulating household supply. Both in NSW and Victoria, retail competition at the household level has been accompanied by safety nets that make it

unattractive for retailers to poach customers. This on-going regulation of retail supply has resulted in some market confusion and is reported to have been the straw that resulted in two of the five original owners of Victorian retailers exiting the market. Commercial customers have seen a churn rate from their host retailer of about 40% but the regulations in place have meant that fewer households have switched retailer.

Other developments have not followed the path that was expected. In the case of transmission, a centrally planned provision was envisaged. However, a situation recognised from the outset was that transmission and new generation are alternatives. If transmission is provided free or at regulated prices this may discourage a more rational and lower cost development of new generation.

This led to provision being made for entrepreneurial interconnects in the National Electricity Law. And Transenergie, a subsidiary of Hydro Quebec, has started building these entrepreneurial links. This has in turn given rise to issues concerning the circumstances under which a *regulated* augmentation of links should be permitted. The danger is that links which are financed by a compulsory charge on the customer, might lead to incentives to site generation in places that are distant from major markets. If someone else is paying for transmission, the rational generation business will have little regard for the costs involved.

### ***Privatisation in Australia***

*"Until self-trained economist Edwin Chadwick came along, 19th-century Britain had a huge problem with its convicts bound for Australia: most were dying before they reached the "fatal shore" down under. Chadwick, however, proposed a solution as effective as it was simple. Instead of paying sea captains by the number of convicts that boarded their ships, he suggested paying them for the number of convicts who disembarked from their ships -- under their own power. It worked. Soon after Chadwick's policy was implemented, convict survival rates surged to over 90 percent."*

"Entrepreneurial Economics for Fun, Profit, and a Better World," by Alex Tabarrok (May, 2002)

Private ownership uses those same insights that Chadwick discovered two centuries ago. It is based on incentives and, harnessed with competition to meet market needs, is the most powerful means of promoting efficiency and high living standards.

Fifteen years ago, following a century of increasing government ownership, it was a new concept.

Over the past dozen years, well in excess of \$100 billion of previously owned government businesses have been sold to the private sector. In terms of industry sector these were dominated first by the government's half float of Telstra and secondly by the electricity and gas industry. Electricity and gas comprised 27 per cent of the sales.

Moreover, the sums raised from privatisation understates the magnitudes involved since, concurrent with and subsequent to it, there has been considerable new private investment in areas formerly reserved for government.

Privatisation in Australia was sparked by the Thatcherite revolution.

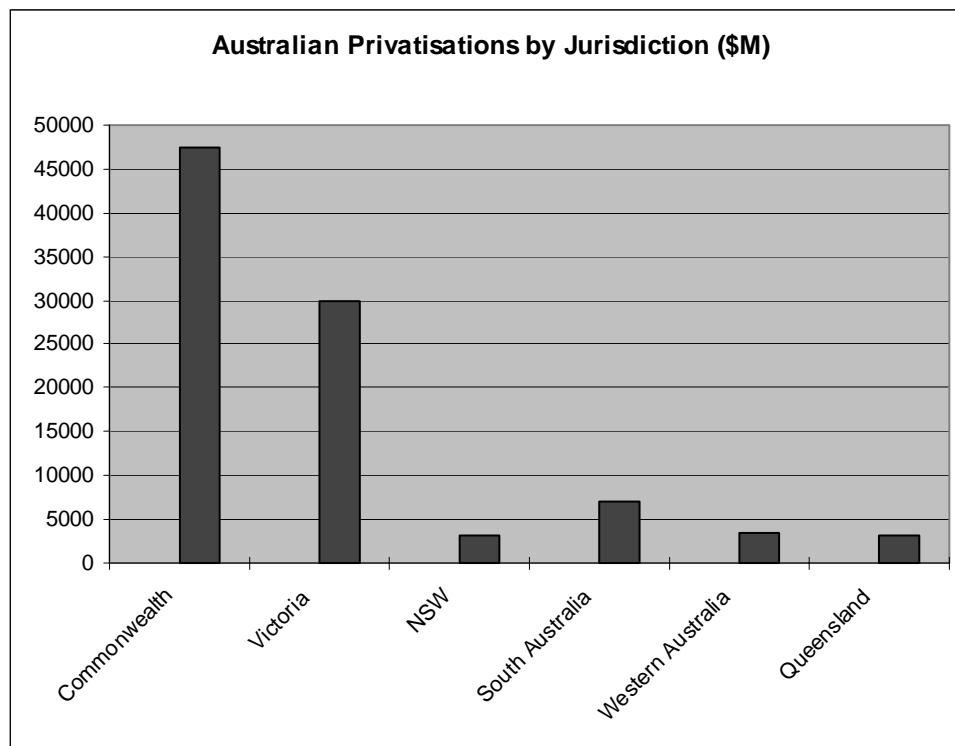
The Federal Labor Government in the 13 years from 1982 privatised areas where government business entities were heavily involved in a competitive business environment. The entities included the Commonwealth Bank, Qantas and the Moomba to Sydney pipeline business.

Massive impetus to privatisation was given by a collapse of State Government financial instrumentalities in the early 1990s. Not only did this reveal mismanagement that shook the confidence of those championing State owned business, but the consequences also placed the State Governments that had presided over these businesses in a parlous financial position.

The most serious was that of Victoria and the Liberal/National Government elected in 1992 embarked on a vigorous privatisation program. Victoria's privatisations were worth \$30 billion, equivalent to twice the value of the other states combined.

Revenues raised by privatisation in each jurisdiction are shown in Chart 1.

**Chart 1**



Sales of Victorian electricity assets between 1993 and 1999 realised \$21.4 billion, with gas assets realising a further \$6.5 billion. These funds comprised the lion's share of the State's \$30 billion asset sales and were used to pay off State debt which was reduced from 26.7% of State Gross Product to 3.1% in June 2000.

According to the Auditor-General<sup>2</sup>, excluding certain franchise fees and other payments the estimated sales values and the average Price/Earnings as follows:

**Table 1**

<b>SALE PROCEEDS AND EARNINGS MULTIPLES ACHIEVED FROM THE SALE OF ELECTRICITY ENTITIES (a)</b>				
	<i>PowerNet Victoria</i>	<i>Southern Hydro Ltd</i>	<i>Electricity generation businesses</i>	<i>Electricity distribution businesses</i>
<i>P/E multiples Average</i>	12.3	14.5	12.0	13.9
<i>Sale proceeds (\$m)</i>	2,545	398	9,001	8,270

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 (a) The earnings multiples are based on projected earnings before depreciation, interest, tax and abnormal items (EBDIT), as per the Information Memorandum for each company (in nominal dollars).

The Auditor-General put the annual savings, net of dividends that might otherwise have been expected, in 1997/98 at \$760 million, a sum that would have been expected to increase year by year. This was equivalent to some 9 per cent of the State Government's own taxation raisings. Furthermore, the debt alleviation and other reforms to State Government finances led the debt rating agencies to raise the State's rating from A-1 to AAA. This brought about further savings in terms of interest charged on debt.

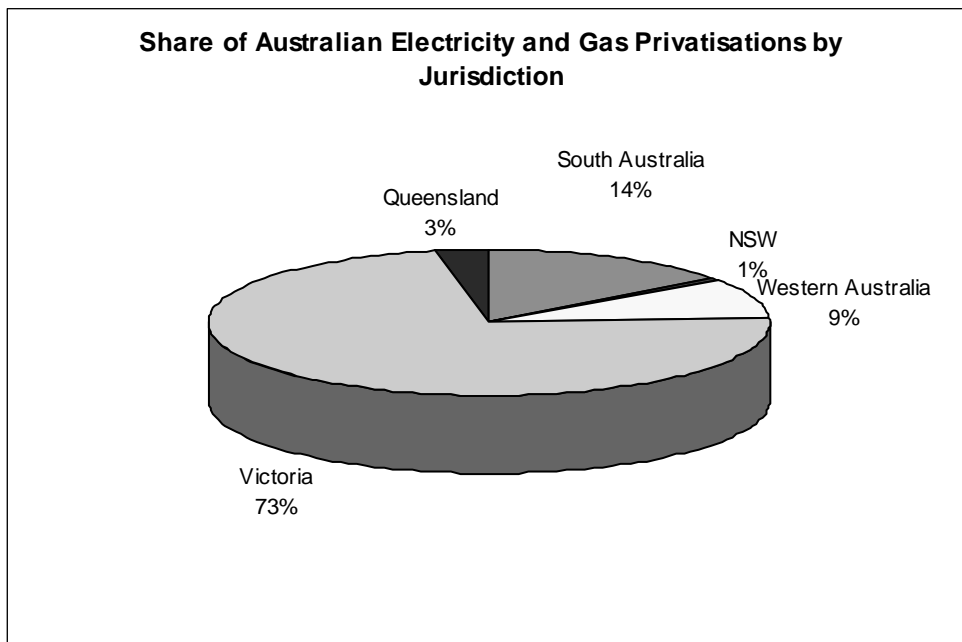
Although Victoria's asset sales progressed somewhat independently of the National Competition Policy reforms, the sales actually brought a melding of the deregulation, and privatisation policy strands targeted at business efficiency.

Electricity and gas asset sales across Australia raised over \$38 billion during the decade to 2001. Aside from Victoria, only in South Australia were assets comprehensively privatised.

Chart 2 illustrates the sector's asset sales by State

<sup>2</sup> <http://www.audit.vic.gov.au/mp98/mp98t&f.htm>, paras 3.8204-3.8206

**Chart 2**



## ***Outcomes of the National Electricity and Gas Reforms***

### **Price outcomes**

In real terms electricity prices have been reduced over the six years to 2002/3, years that roughly corresponded to the period during which privatisation and market provision took place. Except for larger customers, the period was largely characterised by price controls rather than a true market provision. Nonetheless an increasing share of the market became contestable even though price caps were in place for the smaller customers.

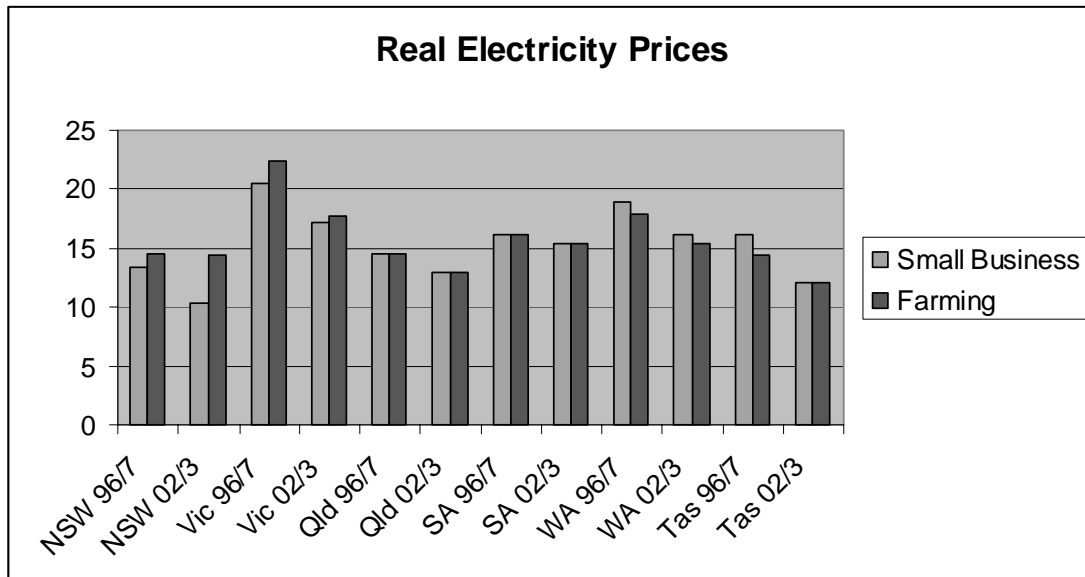
Having prices being set by government institutions is highly imperfect. However, the institutions advising on the price setting are somewhat at arms length from the political process and are, therefore, more attuned to the need to ensure prices are cost-reflective rather than politically set.

In the period under consideration, electricity prices were reduced for almost all customers. Those customers in rural areas saw a lesser degree of price falls as suppliers sought opportunities to rebalance their tariffs away from the cross subsidies that were (and remain) in place. Of course, it could be argued that those cross subsidies confer a benefit on the customers who see lower prices but that benefit can only be at the expense of the customers doing the subsidising. And the subsidies create artificial incentives to consume more power where it is more expensive to do so and less power where it is cheaper to do so. The net effect of the pluses and minuses is negative for the community as a whole.

Chart 3 illustrates the price movements that have occurred (expressed in 2002 cents per kwh). Farming tariffs are used as a proxy for the regional prices.



**Chart 3**



Source: Productivity Commission

These price outcomes stem from a number of different factors that are addressed in subsequent part of this submission. Chief among them are the lower costs brought about by privatisation and corporatisation including:

- eliminating over-manning at power stations; thus in Victoria, there were in the early 1990s some 10,000 people employed in electricity generation compared to less than 2,000 direct employees today (to which should be added the equivalent of about 500 in employee equivalents involved in contracted-out work); this has taken place in a system that has increased its output by 35 per cent.
- improving the operations of the power stations so that they are available to run for a greater amount of time;
- reducing distribution costs from innovations like live-wire maintenance; and
- outsourcing generally, including competitive bidding for extensions and augmentations.

These and other economies have more than offset the increased costs that have developed as a result of the load becoming more peaky and requiring increased capacity due to the growth of summer air-conditioning demand.

### **System reliability**

Increased prominence has been given to system reliability after well publicised area-wide failures in the north east of the North America and in Italy. Some have placed the blame on such failures on the market system putting a greater priority on profit maximisation and correspondingly reduced emphasis on built-in redundancy.

A sample of two major failures is a slender basis for building an empirically based case. This is especially so when it is considered that the other major failure – and one involving a more prolonged outage – was that of the publicly owned system serving

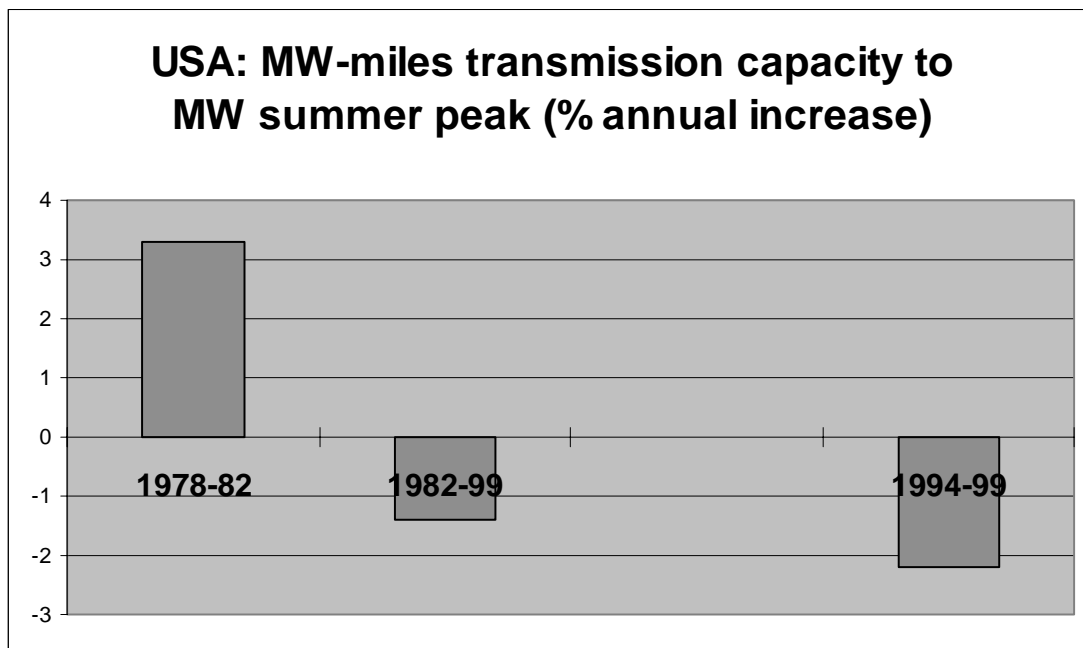
Auckland. Even in this case some writers (e.g. John Quiggin) have sought to portray it as a failure of privatisation since the New Zealand system had been corporatised<sup>3</sup>.

It is however likely to be more than coincidence that the recent failures in Italy and the north east of North America were widespread. This is because systems have developed to be far more integrated over the past few years. The increased integration has been put into place to allow trading of power so that supply is at lower costs and to allow greater sharing of power in emergencies, with the first of these being the dominant motivation. Increased integration, as well as offering back-up to combat a localised outage, also brings the potential to create rolling outages as a result of the integration. This was the case in both the recent major outages.

Even so, the US Federal Energy Regulatory Commission (FERC) has sought to encourage greater integration with its proposal for a Standard Market Design with all significant supplies and loads being brought within one of five regional groupings. This is facing opposition, though largely from jurisdictions that would see power from their areas exported to high price areas, thereby raising the price in the exporting area.

One disturbing feature in the developments of integrated markets in the USA has been the lag in new transmission developments. The following chart illustrates a seemingly accelerating decline in transmission relative to demand.

**Chart 4**



Source FERC

The reduction in transmission capacity in relation to demand doubtless contributed to the rolling breakdown in the north east and was also a factor in the Californian “system meltdown”. The reasons for the US reduced capacity build include opposition by local NIMBY groups to power lines crossing land near to them and the difficulties in arranging for adequate remuneration. The (FERC) has sought to

<sup>3</sup> The most well known Australian failure, Victoria’s gas outage in 1998, was for a system that had always been under private ownership.

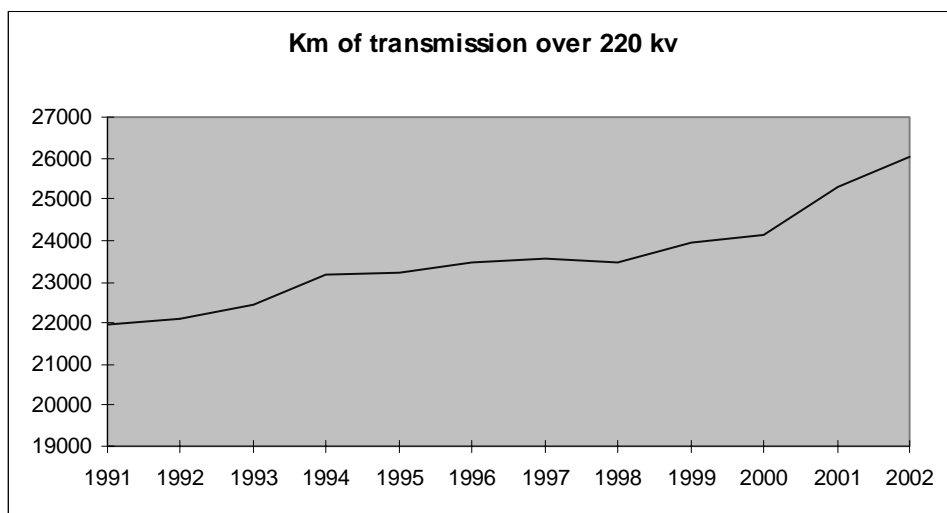
encourage increased transmission including through approving “merchant” transmission that is built entrepreneurially and which depends on users’ willingness to pay for its viability. Such plants with present alternating current technology present considerable control problems. They are practical with direct current and Australia has two of the most notable examples, though neither has proven to be commercially viable.

Lack of transmission capacity is not a major issue for system reliability in Australia’s electricity industry. Those seeking transmission augmentations largely make their case on cost savings through the availability of cheaper power. This reflects a situation of overbuilding of electricity transmission (and of base load power plants) under the integrated government systems that prevailed prior to national competition policy.

At issue with transmission in Australia and elsewhere is determining the appropriate incentives to build the correct amount of new capacity. The problem is plagued by the natural monopoly features thought to be inherent in electricity transmission and the alternative means of meeting load growth through either transmission and generation. Where generation is market-provided and transmission is supplied by a regulator deeming a market to require it, there are great risks of the alternative decision routes creating inefficiencies. These arise either because the regulated approval is over-conservative or because the threat of such approval might undercut the profit projections for a new merchant capacity generator.

The Australian transmission grid, much of which was overbuilt under the integrated state supply systems, has continued to expand as shown in the chart below. Even so, the means of bringing new transmission capacity on stream and at the right time continues to be an area of considerable discord in Australia and elsewhere.

**Chart 5**



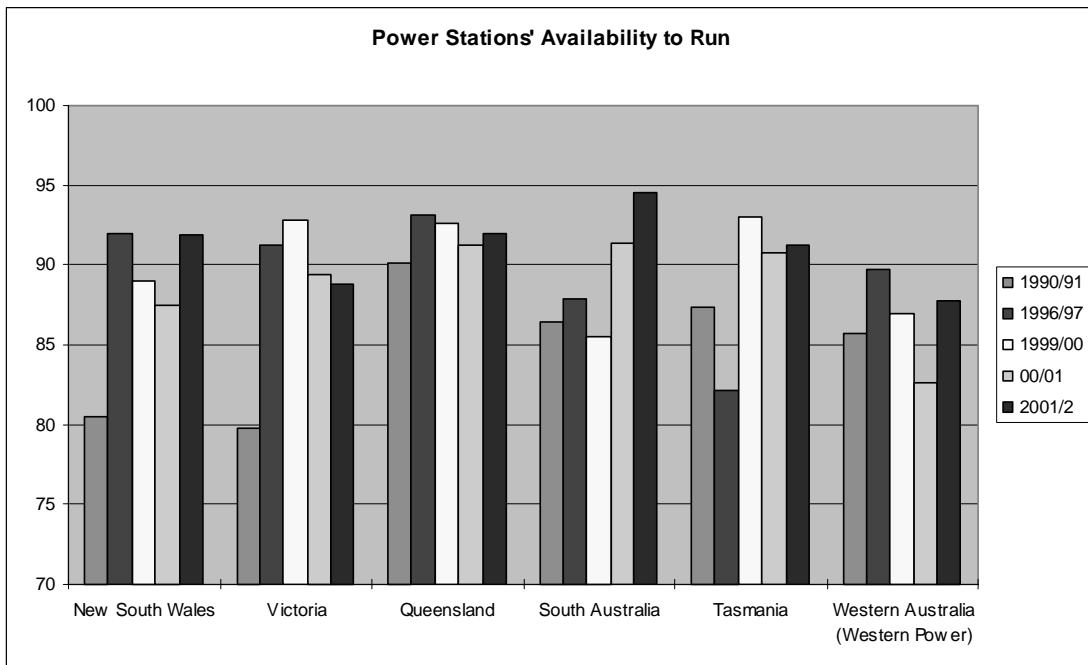
Source ESAA

## Power Stations' Efficiency Levels

Since markets provided the disciplines to force improvement, there have been some quite dramatic advances in outcomes. The availability of power stations to run is one indicator of the readiness of power stations to offer electricity into the grid. A high level of availability will mean a system that needs less reserve capacity, thereby making cost savings, and/or a system that is more reliable due to the capacity ready to be called into supply.

Chart 6 shows the improvements in power stations' availabilities to run across the different jurisdictions. The privatised Victorian system's performance is on a par with that in other jurisdictions in spite of it being based on brown coal stations which are intrinsically less flexible than gas and black coal fuelled stations. The privatised South Australian system is now leading in availability to run.

**Chart 6**



Source ESAA

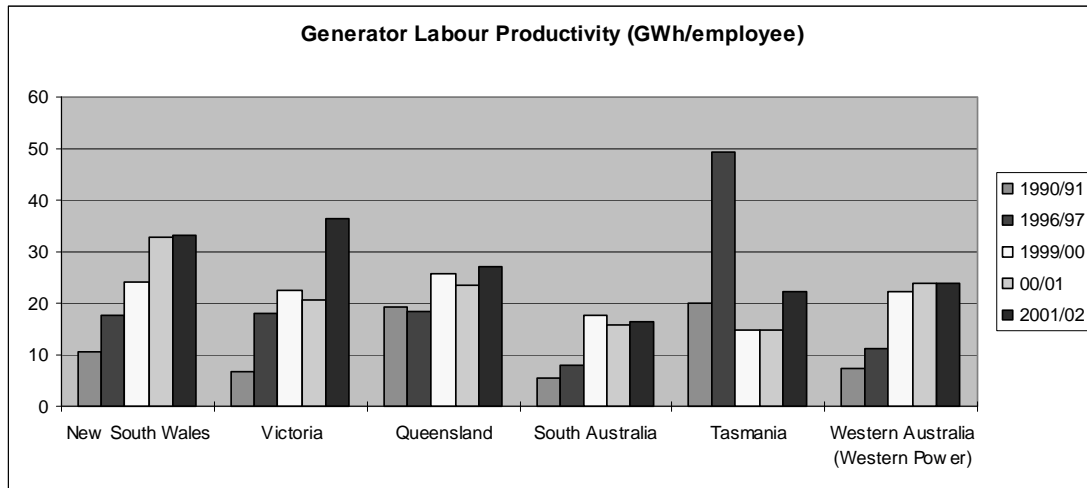
An even more impressive outcome emerges from analysing labour productivity. Measured in terms of electricity output per employee, over the eleven years from 1990/1 productivity increases of 79 per cent, 130 per cent 42 per cent and 103 per cent were achieved for NSW, Victoria, Queensland and South Australia respectively. While this overstates the increase as a result of the greater use of contractors, it is clear that a vast upsurge in efficiency has taken place. The increased output per worker has been achieved with lower pool prices and contract prices that even in nominal dollar terms remain below the levels set on the basis of accountants' advice for the vesting contracts.

Moreover, this has been achieved without major new capital spending. The legacy of over-build from the pre-competition era was such that there has been little augmentation over the past decade. And where new plant has been built, much of it is

in peaking capacity which tends to be more labour intensive as a result of its irregular usage.

Chart 7 illustrates productivity improvements.

**Chart 7**



Source: ESAA

It is true that these improvements in productivity had an adverse effect on the employment in areas where generation takes place, especially the Latrobe and Hunter Valleys. However, employing excessive numbers of people is not a sound means of ensuring sustainable economies, either national or regional. In many cases the electricity businesses in the pre-Hilmer era were used as a sink for job creation but such policies, a re-run of which can be observed in the case being made for subsidising wind power, are always likely to be counter-productive.

There are those that argue, again in the context of wind power, that early action to catch a wave of the future will leave Australia well placed to reap rewards as the technology develops. Such notions are ill-conceived and have little empirical support. Of all the new technology based developments the world over one is hard pressed to find a single instance of subsidies and successful enduring government winner-picking. Certainly not the telephone, the computer (IBM got nothing) the jet engine, the motor car, the tv. Certainly not man-made fibres, the airplane, software or microchips. Indeed, as attested to by countless failed government created “technology parks” (including our very own “multifunctionpolis”), government patronage often brings the kiss of death.

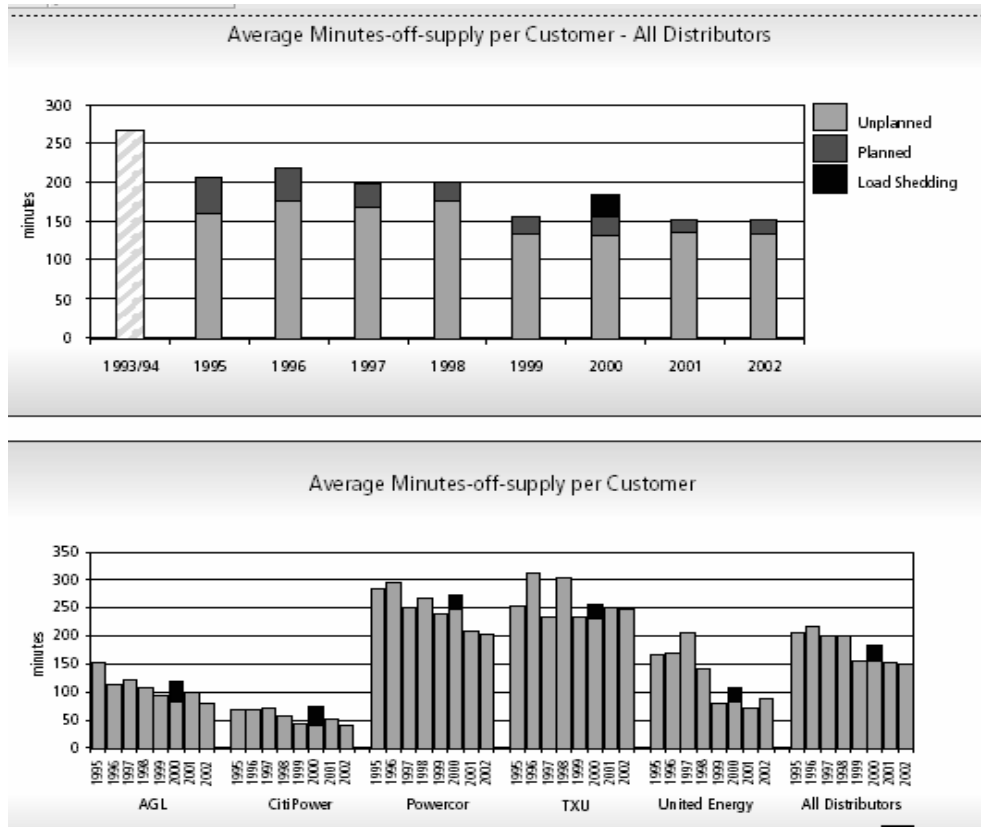
### **The Reliability of Distribution Businesses**

For Victoria, while comprehensive data was not kept of reliability prior to disaggregation and privatisation, there is sufficient evidence available to be confident that the reliability of the system has improved. This is shown in Chart 8.

Victoria’s Essential Services Commission collects data by distribution business. The two charts below outline the data on minutes off supply. They show a progressive

improvement in all five distribution businesses and a marked improvement since 1993/4, the last full year of operations of the SECV. Although the reliability of the rural system, a proxy for which can be seen on the second part of the chart with Powercor and TXU, is not on a par with the urban system it has shown a clear improvement over the period. Rural systems generally are not as reliable as urban systems for a number of reasons. These include the inherent thinness of demand and consequent inability to justify the same level of built-in redundancy, and the longer distances that crews must travel to fix breakdowns.

**Chart 8**



Source: [http://www.esc.vic.gov.au/apps/page/user/pdf/ElecDistReport\\_CalendarYr2002\\_August03.pdf](http://www.esc.vic.gov.au/apps/page/user/pdf/ElecDistReport_CalendarYr2002_August03.pdf)

IPART of New South Wales also collects this sort of data for the state's corporatised distribution businesses. As the following table shows, the number of planned interruptions in NSW appears to have increased over recent years, particularly outside of the main urban area covered by EnergyAustralia.

Unfortunately information is not available on unplanned outages and the history is not readily available for earlier years.

Table A4.5 Number of planned interruptions to supply

DNSP	1998/99		1999/00		2000/01		2001/02	
	No.		No.		No.		No.	
Australian Inland	186		363		442		749	
Country Energy							6,419	
Advance Energy	1,519		1,687		1,648			
Great Southern Energy	2,380		2,613		2,142			
NorthPower	1,766		2,470		2,553			
EnergyAustralia	850		983		986		967	
Integral Energy	1,428		2,156		2,886		2,841	
<b>Total</b>	<b>8,129</b>		<b>10,272</b>		<b>10,657</b>		<b>10,976</b>	

Table A4.6 Number and percentage of planned interruptions to supply where DNSPs did not provide the required notice to affected customers

DNSP	1998/99		1999/2000		2000/01		2001/02	
	No.	%	No.	%	No.	%	No.	%
Australian Inland	0	0.0	4	1.1	11	2.5	0	0.0
Country Energy							92	1.4
Advance Energy	37	2.4	18	1.1	20	1.2		
Great Southern Energy	na	na	na	na	20	0.9		
NorthPower	14	0.8	4	0.2	12	0.5		
EnergyAustralia	20	2.4	20	2.0	12	1.2	4	0.4
Integral Energy <sup>53</sup>	na	na	14	0.6	73	2.5	7	0.2
<b>Total</b>	<b>71</b>	<b>0.9</b>	<b>60</b>	<b>0.6</b>	<b>148</b>	<b>1.4</b>	<b>103</b>	<b>0.9</b>

Source: Electricity distribution and retail licences Compliance report for 2001/02 Report to the Minister for Energy; <http://www.ipart.nsw.gov.au/>.

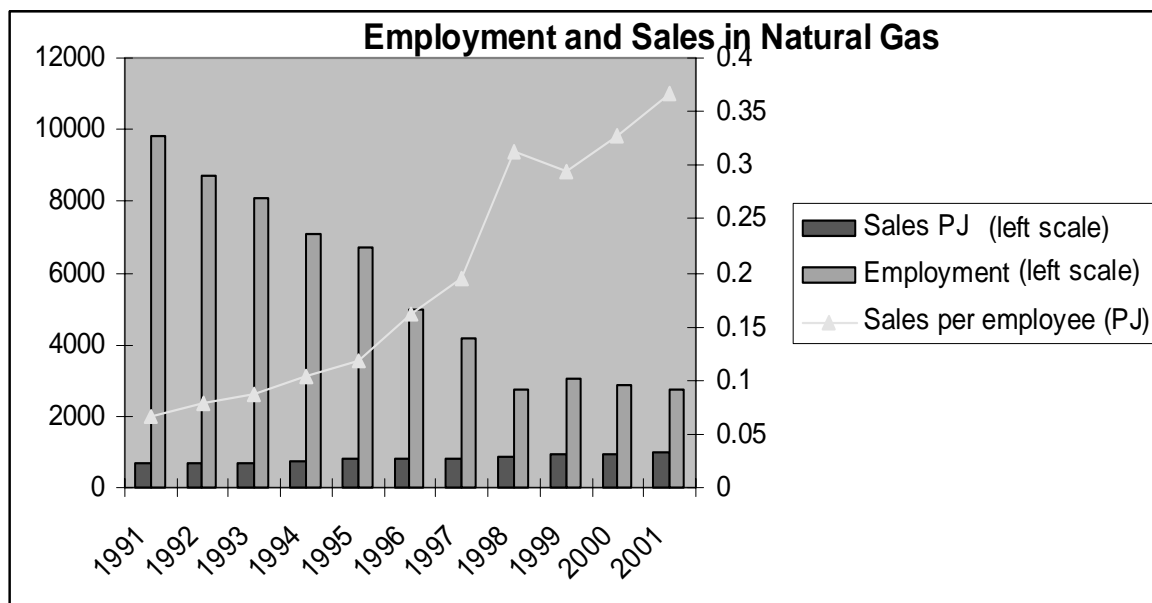
Although the information for NSW is fragmentary, this indicator would appear to suggest the system in that State has not shown the degree of improved reliability that is apparent in the privatised Victorian system. Other evidence that may similarly be interpreted to show other than an expected level of improvement includes data on call centre drop outs and street light repairs.

## Gas Supply Industry Efficiency Levels

The gas industry has seen quite remarkable improvements in efficiency over the past decade. Sales per employee in terms of gigajoules have increased more than fourfold.

Sales and employment are shown in the following chart.

**Chart 9**



Source: AGA

Real gas prices have tended to fall in Victoria. For business tariff customers in Victoria and WA have declined by between 4 per cent and 25 per cent. Prices for small business in non-metropolitan WA increased by around 5 per cent over the decade to 2001.

For household users in Victoria, prices in 2000/1 were 7 per cent above 1990/1 levels but 7 per cent below 1993/4 levels. The table below summarises the trend for TXU, a major rural supplier. Household tariffs were fixed by regulation over the period and therefore do not indicate market factors.

**Table A3.2 Real gas price trends — households, TXU Retail (Victoria)**  
1990-91 to 2000-01 (index 1990-91=100)

	<i>Metropolitan and non-metropolitan</i>
1990-91	100.0
1991-92	103.5
1992-93	106.1
1993-94	114.0
1994-95	113.4
1995-96	109.9
1996-97	110.7
1997-98	111.9
1998-99	109.8
1999-00	104.6
2000-01	107.4

Note Real price indexes were calculated using the tariff applicable to average annual consumption of 57.8 GJ. Consumption during the winter months June to September was assumed to be 55 per cent of annual consumption. Tariffs were deflated by the CPI (All groups) for Melbourne. The nominal price series for 2000-01 includes the Goods and Services Tax. Prior to January 1999, prices were based on Gas and Fuel Corporation tariffs.

Source: PC estimates based on ABS (*Consumer Price Index, Australia*, Cat. no. 6401.0); Victoria Government Gazette (1997 and previous issues); Victoria Government Gazette (1998).

Real average prices for (mainly large) business contract customers, which are not fixed by regulation, appear to have declined in Victoria and WA. The trends for



individual contract customers will depend on the extent of their unique transmission, distribution and retail charges. The figures below illustrate this.

Figure 3.6 Real gas price trends — business, AlintaGas (WA)  
1990-91 to 2000-01

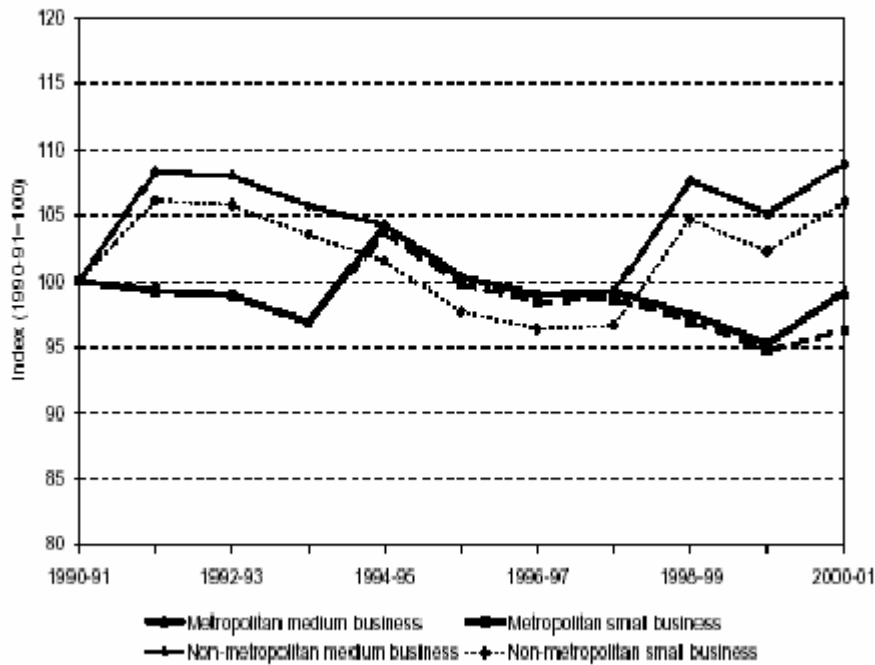
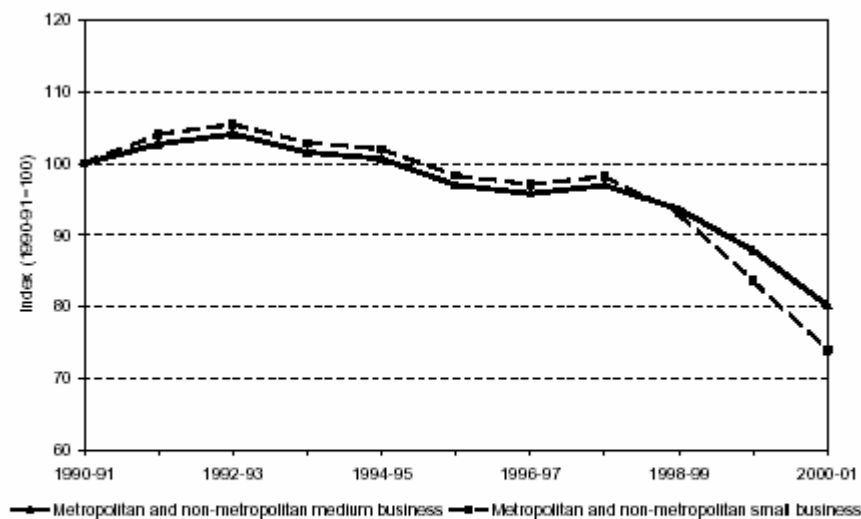


Figure 3.5 Real price trends — business, TXU Retail (Victoria)  
1990-91 to 2000-01



Note Price indexes were calculated using an annual consumption level of 500 GJ for a small business and 10 000 GJ for a medium sized business. The pattern of consumption is assumed to be uniform throughout the year. Prices were deflated by the CPI (All groups) for Melbourne. The nominal price series for 2000-01 exclude the Goods and Services Tax. Business prices do not vary between metropolitan and non-metropolitan areas because uniform tariffs apply throughout TXU Retail's franchise area. Prior to January 1999, prices were based on Gas and Fuel Corporation tariffs.

Data source: PC estimates based on ABS (*Consumer Price Index, Australia*, Cat. no. 6401.0); Victoria Government Gazette (1997 and previous issues); Victoria Government Gazette (1998).

There is little trend data on reliability of gas services but the ESC in Victoria assessed reliability to have remained stable between 1999 and 2001.

## **Gas Transmission Developments**

Existing gas pipelines have not required any special incentives for expansion to ensure on-going system security and to meet augmented demand. One exception to this appears to be the Dampier to Bunbury Natural Gas Pipeline which has a regulated price cap imposed upon set at a level that the pipeline owners' claim will not only require its sale but will also make expansion of capacity to meet demand growth non-viable.

Price capping will always carry the potential for regulatory mistakes, like that claimed to have taken place with the DBNG pipeline, and consequent under-building. For this reason and to allow a market (rather than politically) determined expansions government institutions should exit regulation of pipelines that are not presently in place and of those where more than one pipeline serving a load allows workable competition.

The ending of the regulated monopolies in gas pipeline provision that followed from National Competition Policy brought a raft of new pipelines including the Duke Energy pipeline from Bass Strait to Horsley Park (Sydney) and the SEA Gas line from Port Campbell to Adelaide. However there is clear evidence that the regulatory arrangements are causing a hiatus in new developments. One example of this is the decision by Duke Energy, one of the most aggressive builders of new pipelines, to cease examining new build opportunities. Duke Energy has cited regulatory measures as the reason for this decision.

Table 2 below identifies recent new pipeline projects.

**Table 2**

Project	Potential consumers	Competitive tender held	Estimated project value	Outcome
Tasmania (2002)	385 000	Yes	\$200.0m	Project delayed – ongoing government funding negotiations with preferred distributor
Loddon-Murray Region (2001)	15 000	Yes	\$50.0m	Project shelved
North Bellarine Peninsula (2000)	4 000	No	\$11.0m	Proceeding following government funding – completion due 2004
Barwon Heads (2000)	1 300	No	-	Project deferred
Cardinia Shire (1999)	2 300	No	-	Completed
Yarra Ranges (1999)	14 000	Yes	\$16.0m	Project shelved
East Gippsland (1999)	22 000	Yes	\$14.0m	Project delayed
Central Ranges (1999)	50 000	Proposed	\$96.0m	Project delayed

Source: AGA

### ***Government and Energy Operations***

Deregulation has enhanced the level of improvement, confirming the judgements stemming from applied economic theory which would predict positive outcomes from clear ownership rules and a competitive environment. The present arrangements with either private ownership or publicly owned entities operating under company law have brought vast improvements in efficiency and lower prices with increased reliability. Few would argue for a return to integrated monopolies in the energy supply industry.

Indeed, it is Government intervention that has given rise to many of the developments where the energy market has not delivered as beneficial an outcome as might have been hoped. These intrusions go beyond the sort of commercially directed interventions discussed above and include regulatory over-reach by the “independent regulatory agency”, the ACCC. Such over-reach has had a disincentive effect and has distorted investment decisions, particularly with respect to gas.

Privatisation is often cited as having brought increased prices and reduced reliability. However, a cool assessment of the Australian energy sector has shown it to have brought the opposite effect. Privatisation offers advantages over corporatisation in four areas.

First, governments as owners are always likely to interfere or place particular pressures on the management to operate in ways that are not fully commercial. This may well be the case, for example, with the enterprise agreements. The corporatised firms in NSW and Queensland are aware of their shareholders' opposition to Australian Workplace Agreements that involve a much reduced role for trade unions. Accordingly it is unlikely that they would seek such an approach rather than Enterprise Based Agreements, especially such agreements that did not involve a key role for trade unions. Such restrictions on management options would tend to reduce the firms' relative efficiencies.

Secondly, government ownership has the potential for appointments that are based on patronage rather than management capabilities. NSW government firms learned some very hard lessons about the dangers of not ensuring fully professional management. One was delivered by Victorian retailer Powercor, which signed contracts for electricity from NSW's Pacific Power at knock down prices. The NSW Government tried to wriggle out of the contracts but the courts upheld the contract. As a result, NSW taxpayers have incurred a loss of some \$600 million.

Thirdly, ownership even when there is arms length management, cannot eradicate the conflict of interest between the government as a player and the government as the upholder of the law. An example of this is illustrated by the NSW Government's actions with regard to an unwelcome contract signed by EnergyAustralia. EnergyAustralia, the biggest retailer in the NSW (and in Australia), signed a 35 year deal with an American firm for two new power stations, Redbank 1 and 2.

Soon after the deal was struck, the price in the market halved and remains 30 per cent below the Redbank contract price. Some estimates put the contract loss on at \$750 million. Redbank 1 has been operating for the past two years. But Redbank 2 is still not built and the NSW Government set up an inquiry into it. Citing greenhouse gas emissions, the Government has refused it development approval, thus avoiding an onerous contract. Using approval processes to cancel debts smacks of banana republic government practice and could undermine confidence in this and other areas.

A further example of the over-use of government influence in pressing for a commercial outcome is seen with the NSW electricity transmission operations. The NSW Government also placed a major priority on having the authorities approve a new regulated electricity transmission line to South Australia. In pursuing this regulated investment approval for a line that would benefit the state owned power stations the NSW government became a participant in an activity which should have been resolved by commercial considerations and established regulatory procedures.

Another instance of counterproductive policy approaches that are only likely to occur with government ownership was cited by the Parer inquiry<sup>4</sup>. The Parer committee was highly critical of arrangements that NSW and Queensland have in place to try to prevent electricity price volatility. These involve a form of mandatory insurance. The Parer report argues that the arrangements impede competition and market efficiency.

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<sup>4</sup> <http://www.energymarketreview.org/>

Fourthly, government owned firms have a greatly reduced capacity to transform their management. Private firms' owners have an exit strategy involving selling the business to new owners where these owners consider they can operate it more profitably. Such reselling has occurred on at least a dozen occasions with the Victorian and South Australian privatised gas and electricity businesses.