SUBMISSION NO. 11

CORPORATE SERVICES
Government of Council

City of Townsville

TOWNSVILLE CITY COUNCIL

SUBMISSION TO INQUIRY INTO PRIVATISATION OF REGIONAL INFRASTRUCTURE AND GOVERNMENT BUSINESS ENTERPRISE

NOVEMBER 2003

ABN >> 81 143 904 097

1. Economic impact of the privatisation of infrastructure and government business enterprises in rural and regional Australia

Infrastructure as a 'necessity' good

In this day and age, goods and services such as power, communications, road, rail and air are essential or 'necessity' goods for the community and industry in much the same way as water or wastewater treatment. Any failure in the delivery of these goods and services has a severe and unacceptable impact on the community and industry and has traditionally resulted in the public sector providing these goods and services.

The question that arises in the context of a failure in the privatised delivery of these goods or services is who bears the risk. There is evidence from previous examples of failure in the privatised delivery of 'necessity' goods and services that the public sector is ultimately responsible for the risk regardless of the apparent transfer of ownership, control and responsibility to private entities. Wastewater treatment in Adelaide and water treatment in Sydney are examples of this failure to transfer risk and responsibility for failure from the public sector when privatisation occurs.

Residual risk remaining with the public sector should be considered in any cost benefit assessment of whether a particular 'necessity' good or service is best provided by the public or private sector. It is doubtful that public sector *residual* risk is currently taken into account in decisions to pursue privatisation. This issue of residual risk could be reduced by provisions in contracts or agreements that require the private provider of 'necessity' type goods or services to have bank guarantees or insurance policies in place to allow the immediate rectification of failure and its consequences.

It is also important to take into account features of business behaviour in our market system that impact adversely on the provision of 'necessity' type goods and services. The first feature is the tendency for business to focus on a time table for return on investment that is much shorter than the whole of life returns for the infrastructure involved. The three year investment horizon tends to dominate modern business thinking. The result of this short horizon is that the goal of maximising profits can result in cost cutting or deferment of essential expenditure. Maintenance of infrastructure is an obvious candidate in this regard for short term cost cutting. This in turn increases the likelihood of failure in delivery and associated residual risk for the public sector.

The second feature of business behaviour is to restrict capital expenditure to a 'just in time' basis. In certain cases infrastructure supplying 'necessity' goods or services operates in a monopoly or near monopoly situation. A slow rate of investment in the face of increasing demand results in excessive profit taking. Similarly there is a strong profit incentive to extend the economic life of existing infrastructure beyond its planned obsolescence or regardless of the introduction of new technology. Competition is the best remedy in this area

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but is not possible leading to cost impositions of the public sector in setting up regulatory oversight bodies. The cost of regulatory oversight by the public sector is akin to the issue of residual risk and should be taken into account in the cost benefit assessment of whether the public or private sector should be best placed to provide 'necessity' type goods and services. It is also doubtful that regulatory bodies can impose capital expenditure obligations on these private infrastructure suppliers.

Market Structure

There has been a trend to centralisation of operations by major business. Issues such as market size, distance from market and economies of scale, may force privatised public corporations to centralised business functions thereby further impacting on regional economy through employment and purchasing.

2. Social impact of the privatisation of infrastructure and government business enterprises in rural and regional Australia

Pursuit of Social Objectives

Privatisation can make it harder to pursue social and other non-commercial objectives.

For example, it has been stated, in relation to the use of private sector funding for major transport infrastructure in Sydney (Glen Searle, "New Roads, New Rail Lines, New Profits: Privatisation and Sydney's Recent Transport Development, Urban Policy and Research, Volume 17 No.2, 1999), that "this strategy, and the profits it has produced for investors, have come with major costs for the rest of the community. In particular, it has mostly served to reinforce Sydney's car dependency and exacerbate the environmental and equity costs of such dependency".

Such writer states " the privatisation of Sydney's transport development is bringing forth a truly post-modern fragmented landscape of scattered new lines and roads from which the private sector can make profit, in a sea of transport needs demanding the application of a coherent plan reflecting critical equity and environmental issues."

Public enterprises are often required to pursue social objectives in relation to regional development, environmental protection, income distribution and industrial and human resource development. The privatisation of such 'public services' will no doubt make it much more difficult for the enterprise to pursue such objectives which could be seen to be largely inconsistent with the profit making objectives.

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Similarly, government have shown limited interest in providing funding from general revenues (despite general revenue being boosted by returns from capital released by the sale of these assets) to cover these social objectives once the means of cross-subsidisation via 'non commercial' objectives disappears.

Unemployment

If it is assumed that the privatisation of public services is driven by the motive of optimising profits, it could be expected that the first impact could be on employment. In regional Australia, workers displaced by privatisation, may experience prolonged period of unemployment. Although it might be argued that losses experienced as a result of higher unemployment will be offset by gains in other sectors, the regional impact of loss in employment should be included in any cost benefit assessment before any privatisation occurs. In short, privatisation may often require structural adjustment programs to integrate short to medium term impact on employment. This will be particularly the case where regions are not growing or have low base industry diversity. (See also, Productivity Commission, Impact of Competition Policy Report on Rural and Regional Australia, Chapter 10, May 1999).

3. Benefits and disadvantages of privatisation in the rail, road, aviation, ports, power and industrial manufacturing sectors

Will privatisation lead to greater efficiency?

While the background paper gives no clear indication of the objective of considering the privatisation of essential public services, it is inferred that it is to do with microeconomic reform leading to more effective and cost efficient services.

In respect to rail, road, and ports, these services are largely provided through public monopolies. It can be argued that these services are in fact 'natural' monopolies. Such services are more efficiently undertaken by a single entity.

If a public monopoly were converted to a private monopoly, efficiency gains would not necessarily be achieved. The price setting behaviour of a private monopolist is unlikely to be consistent with maximising allocative efficiency and regional and rural Australia could stand to be considerably disadvantaged through, for example, poor capital investment decisions and poor pricing decisions.
(These issues are well canvassed in EPAC Paper No. 17 'Efficiency in Public Trading Enterprises' January 1987).

The proposition that regulations can be imposed to address allocative efficiency, such as pricing or levels of service, is not well accepted in regional

Australia due to the ability of private monopoly providers being able to get around such regulations.

The issue of whether privatisation would promote improved management of services in regional Australia would largely depend on whether pressure imposed by shareholders on Boards would be more compelling than the pressures imposed by Government on public enterprises. Shareholders in the long run are concerned with maximising company profits and it is unlikely that they will change in respect to private monopolies. There have been reports of shareholder taking action under the Corporations Law if Telstra was pressured by the Government to deliver uneconomic services to rural areas.

In summary, opening up services to more competition for such services as rail, road and ports to promote greater efficiency could have counter productive outcomes. The extent to which efficiency gains will be achieved will largely depend on the competitiveness of the environment in which these services operate. At the same time, for the services being considered, the 'one producer' arrangement is the one most likely to deliver the efficient allocation of resources in the long run.

4. Policies, measures, and other factors that would assist developing world class infrastructure

Lack of national infrastructure planning

There is a serious deficiency in national infrastructure planning. The establishment of a National Infrastructure Advisory Group is recommended in the Commonwealth Department of Transport and Regional Services Report 'Regional Business – A Plan for Action', 2003 and this recommendation is supported by Council. This Group would in particular ensure that objective prioritisation of major infrastructure projects of national significance that are not likely to attract private sector investment.

5. The role of the three levels of Government and the private sector in providing regional infrastructure

Commonwealth role in provision of public infrastructure supporting private sector investment

To succeed, regional economies must be able to compete on equal terms with other regions and internationally by producing goods efficiently. Power, communications, road, rail and air services play a vital role in this regard and if privatised future investment may be prejudiced. These services require high levels of capital investment and in regional areas there may not be the customer base to provide adequate returns on such investment, hence, investment does not proceed.

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The provision of infrastructure in regional areas has been shown to be poor in current studies. (see Report 'Regional Business – A Plan for Action, Department of Transport and Regional Services, 2003). With the recent trend of private provision of infrastructure, the Townsville region has seen very slow development of some major infrastructure, such as natural gas to power industry, road infrastructure to secure improved port facilities, and port developments to secure increased commercial use of port facilities. Commonwealth and State Government must do more to address this problem.

Urban Renewal

Since the end of the 'Better Cities' program, the Federal Government has played no role in urban renewal programs, yet it has been clearly established that public sector investment in infrastructure, both economic and lifestyle, plays an important role in attracting new private sector investment into an area.

The 'Better Cities' Program was initiated in 1991 to explore new approaches to managing urban development to achieve more efficient, environmentally sustainable and socially just urban growth and change.

The Federal Government committed over $1 billion to investment in Australia's cities through the Program and helped 26 communities through this program. The Program generated 60,000 jobs and released an additional $3.7 billion worth of investment from the private sector and other levels of government.

There is now an urgent need for the Commonwealth to again play a leading role in funding urban renewal infrastructure to ensure, in particular, regional cities continue to play an important role in attracting new investment to its area by providing services and facilities that meet national and international standards.

Private Sector Provision of Infrastructure

A major potential disadvantage in private sector provision of infrastructure is the failure of the private sector to account for non-commercial benefits that arise as a result of the provision of major infrastructure.

The private sector will be largely concerned to achieve adequate returns on capital commensurate with risk before embarking on major new infrastructure projects. Future economic development opportunities, along with social and environmental opportunities, as a result of the provision of infrastructure, may not be taken into consideration in the investment decision.

The public sector funding of infrastructure is important when:

- such infrastructure is not capable in the short term of providing an acceptable commercial return

- may be commercially viable on a smaller scale at the present time but which should be pursued on a larger basis to meet projected long-term needs or demands of the economy; and/or
- generate economic benefits that are unable to be captured directly by project revenue streams; and
- if left to the private sector or a public sector agency alone to fund, is likely to result in either a sub-optimal project size or a deferral of the construction of the project.

Government's attitude of adopting 'least cost/least risk' approach in respect to the provision of what is essentially public infrastructure, could have long term implications for regional economic growth if the private sector fails to deliver.

Major infrastructure such as transport, ports and energy influence locational choices so it is very important that an objective assessment of the benefits and costs of proposals is undertaken before any general acceptance that projects should be left to the private sector is made.

An example in Townsville in respect to the negative impact of delayed private sector investment is in regard to the Stage Two extension of the Sunmetals Zinc Refinery. The non-availability in Townsville of a cost-effective power supply to meet the Company's needs is said to be a continuing issue to be resolved before any such expansion is approved.

The short term solution to convert a peaking plant to a 220 megawatt combined cycle base-load power station, while increasing base load power to the region, should have been pursued on a larger basis to meet the projected longer terms needs of the region.

6. Mechanisms for monitoring, evaluating and reporting on government privatisation programs

It is crucial that 'public benefit' assessments are undertaken prior to any privatisation of a public sector service. Community input must be sought on reform options to ensure that any reform is widely canvassed and the community understands why reform is being considered. As indicated in this submission the social and environmental costs should be given no more or less weight than financial considerations in determining whether the public interest lies.

The challenge for any government considering this question is to focus on outcomes that benefit the community as a whole.