

# CHAPTER 8: STATE ECONOMIC REFORM

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## 8.1 RATIONALE FOR REFORM

New South Wales has been actively implementing economic reform for over a decade. Since 1995, the majority of the reform process has taken place under the auspices of National Competition Policy (NCP). NCP has assisted in coordinating and implementing reforms across jurisdictional borders.

The rationale for NCP is that competition, properly harnessed, can boost economic performance and enhance consumer welfare. But the reasons for reform extend beyond economic efficiency considerations and encompass environmental sustainability and social equity.

New South Wales is at the forefront of implementing NCP reforms to improve the economic wellbeing of Australians. Competition Policy, however, is only one part of the NSW Government's policy aims and its application complements the Government's other policy objectives. The overall rationale of the Government's policy objectives is to improve the living standards of all people in New South Wales.

NSW economic reform has created a more competitive economy and produced a number of improvements:

- ◆ lower prices and increased choice for consumers;
- ◆ greater attention to ecologically sustainable development;
- ◆ increased business choice and innovation;

- ◆ enhanced allocative, productive and technical efficiency;
- ◆ the promotion of equity, as the disciplines of competition become shared more evenly across society;
- ◆ progressive distributional effects as the energy reforms expand to take in the household sector;
- ◆ increased opportunities for NSW business to effectively compete for international market share;
- ◆ strengthened State finances resulting from getting better value for money from expenditure while supporting revenue through economic growth; and
- ◆ an improvement in the productivity and flexibility of the NSW economy (to help protect against external shocks).

## **8.2 NATIONAL COMPETITION POLICY (NCP) REFORM ACHIEVEMENTS**

NCP consists of three inter-governmental agreements: The Conduct Code Agreement (CCA), the Competition Principles Agreement (CPA), and the Agreement to Implement NCP and Related Reforms (RRA).

### **Conduct Code Agreement (CCA)**

The CCA requires the extension of Part IV (which relates to anti-competitive conduct) of the *Trade Practices Act 1974*, to Government Business Enterprises (GBEs) and unincorporated businesses (e.g. professional partnerships) operating within a single State border.

The NSW Government complied with this agreement by enacting the *Competition Policy Reform (NSW) Act 1995*. This Act has applied to unincorporated associations and corporations since 21 July 1996, and to GBEs since 1 July 1997.

## **Competition Principles Agreement (CPA)**

The CPA lists six competition-enhancing principles (discussed individually below) for introduction. The principles mostly apply to GBEs.

### ***Independent Prices Oversight of Government Business Enterprises***

In 1992, the NSW Government established an independent pricing tribunal, the Government Pricing Tribunal (GPT). The GPT was reformed and renamed the Independent Pricing and Regulatory Tribunal (IPART) in 1996. The functions of IPART are essentially to:

- ◆ set maximum prices and review pricing of scheduled monopoly services including electricity, gas, water and public transport; and
- ◆ undertake general reviews of industry, pricing or competition issues as required by the Premier.

### ***Competitive Neutrality***

The objective of this principle is to ensure government businesses do not distort the efficient use of the economy's resources through any competitive advantages as a result of being government owned. Government signatories to the CPA are required to ensure their businesses adopt:

- ◆ a corporatisation model;
- ◆ full Commonwealth, State and Territory taxes or tax equivalents;
- ◆ debt guarantee fees (which, in effect, restore the true cost of debt); and
- ◆ regulations to which private sector businesses are normally subject.

The above requirements may only be exempted where it can be shown that there is a net public benefit from not implementing competitive neutrality.

The NSW Government published its *Policy Statement on the Application of Competitive Neutrality* in June 1996.

A State-Owned Corporation (SOC) model has been adopted in New South Wales and is effectively the basis for compliance with the requirement for competitive neutrality. The *State-Owned Corporations (NSW) Act 1989* creates two alternative SOC structures - a company SOC and a statutory SOC. Both have a board of directors, share capital and a memorandum and articles of association similar to a public company limited by shares. The full extent of *Corporations Law* applies to company SOCs, whereas statutory SOCs are only required to observe the aspects of the *Law* relating to officers' duties and liabilities. To date, corporatisations have occurred in the electricity generation and distribution sectors, ports, transport, and water and waste services.

### ***Structural Reform of Public Monopolies***

This principle requires the commercial activities of a government business to be separated from its non-contestable regulatory functions before it is subjected to competition. The commercial activities are then separated into monopoly activities and competitive (or potentially competitive) activities. This process ensures that any monopoly rents of competitive activities are removed through competition, while IPART's independent price oversight of monopoly elements optimises community benefits.

The NSW Government has been systematically applying the principles of structural reform to its public monopolies, particularly those in the electricity and rail industries.

#### ***Electricity***

New South Wales has restructured the regulatory and commercial sectors of the electricity industry, with the commercial sector further divided into its natural monopoly (transmission and distribution) and competitive components (generation and retail). NSW regulatory arrangements have developed in line with the National Electricity Market (NEM) timetable.

#### ***Rail***

The NSW Government has separated the operation of rail services from the ownership, provision of access, and the maintenance components of the State Rail Authority (SRA).

The restructure of the SRA, outlined in the *Transport Administration Amendment (Rail Corporatisation and Restructuring) Act 1996*, has led to the formation of four entities:

- ◆ State Rail Authority (provides passenger services);
- ◆ Rail Access Corporation (manages the rail network and administers access by public and private operators);
- ◆ Rail Services Australia (undertakes track maintenance on contract to the Rail Access Corporation); and
- ◆ FreightCorp (runs freight services).

### ***Review of Legislation***

This principle requires jurisdictions to review (by the year 2000) legislation 'that restricts competition'. The guiding principle is that legislation should not restrict competition unless it can be demonstrated that the benefits to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.

The determination of whether particular legislation 'restricts competition' and requires review is for each jurisdiction to determine. New South Wales has prepared a comprehensive program of review, encompassing some 200 pieces of legislation identified as restricting or potentially restricting competition.

These reviews have benefited the State by removing certain anti-competitive practices (particularly those relating to statutory marketing authorities), streamlining administrative arrangements, reducing compliance costs and repealing unnecessary (and often outdated) legislation.

### ***Development of Third-Party Access Regimes***

This principle indicates that States can develop regimes for the provision of third-party access to services that are provided by significant infrastructure facilities. State-based access regimes are to apply where:

- ◆ it would not be economically feasible to duplicate the facility;
- ◆ access to the service is necessary in order to permit effective competition in a downstream or upstream market; and
- ◆ access can be provided safely.

### *Electricity*

On 13 December 1998, New South Wales moved from a State wholesale market operating under the *Electricity Supply Act 1995* to the NEM operating under the National Electricity Code. Third-party access provisions are incorporated in the Code. (The NEM is discussed below under the heading 'Agreement to Implement the National Competition Policy and Related Reforms')

### *Gas*

New South Wales has taken a leading role in achieving free trade in gas in Australia. In August 1996, the NSW Government implemented the NSW Gas Pricing and Access Regime. This regime was the first of any State to be certified as effective under Section 44M of the *Trade Practices Act 1974*. New South Wales was also instrumental in establishing the National Third Party Access Code (as part of the *Gas Pipelines Access (NSW) Act 1998*), which commenced in August 1998 replacing the 1996 regime.

The NSW Government submitted its Access Regime (as embodied in the *Gas Pipelines Access (NSW) Act*) to the National Competition Council (NCC) in October 1998 for recommendation as an 'effective regime' under the *Trade Practices Act 1974*. The Council is expected to make a recommendation for certification to the Commonwealth Treasurer in mid 1999.

Third-party access rights for customers have been phased in gradually from 1996. At present, all customers using more than 10 terajoules per annum are able to choose their own supplier. From 1 October, 1999 this will be extended to those using more than 1 terajoule per annum and from 1 July 2000 it will apply to all users.

## *Rail*

In August 1996, the Government gazetted the NSW Third-Party Access Regime for all rail services in New South Wales, along with associated amendments to the *Transport Administration Act 1988*. The Regime was submitted to the NCC for certification as an effective access regime. On 9 April 1998, the NCC issued its draft recommendation on the Regime for public comment, and on 2 November 1998 issued a circular stating that if New South Wales gazetted a Regime in the terms set out in the circular, the NCC would send its final recommendation to the Commonwealth Treasurer for his decision. An amended regime was gazetted on 19 February 1999 and has been provided to the NCC for final assessment.

## ***Application of Competition Principles to Local Government***

The State has made significant progress in applying the competition principles to local government, especially in developing guidelines for implementation. In 1997-98, the NSW Department of Local Government issued various guidelines to local councils on competitive neutrality, including *Pricing and Costing for Council Businesses: A Guide to Competitive Neutrality*. This publication included a timetable for applying competitive neutrality to significant business activities.

## **Agreement to Implement the National Competition Policy and Related Reforms (RRA)**

The RRA includes specific industry reforms (to the electricity, gas, water and road transport industries), which had already been subject to separate agreements. The reforms were seen as crucial to securing the full benefits of national economic reform and were accordingly brought into the NCP package.

The RRA also sets out the conditions under which the Commonwealth Government will provide financial assistance to the States, subject to their being no major financial deterioration in Australia's economic circumstances.

Based on NCC assessment of compliance, the State is expected to receive \$1.4 billion (1994-95 dollars), in financial assistance over the nine years to 2005-06, a per capita allocation of around 34 percent of the competition payments. Payments are also linked under the RRA to Financial Assistance Grant payments, which are paid according to a Commonwealth Grants Commission formula and are worth approximately \$16.1 billion in aggregate to the year 2005-06.

### *Electricity*

New South Wales has been at the forefront of moves to establish a fully competitive electricity market in Australia. Between 4 May 1997 and 12 December 1998, New South Wales, Victoria and the ACT operated an interim NEM in advance of the fully competitive market. The full NEM commenced operation on 13 December 1998, when Queensland and South Australia joined the ACT, Victoria and New South Wales.

New South Wales has operated a competitive market for trade in wholesale electricity since May 1996, and has been progressively introducing competition to retail customers. The first customers became eligible to choose their electricity supplier from October 1996. Since April 1997 users of 4 gigawatt hours (GWh) of electricity per year have been able to choose their electricity supplier. Three months later this was extended to customers using more than 750 megawatt hours (MWh) (generally energy intensive businesses). Since July 1998 customers using more than 160 MWh of electricity per year have been selecting their electricity supplier. Competition derived savings to electricity customers have amounted to \$1.2 billion since 1995.

The next major milestone in the NSW Government's reform of the electricity industry is to open the retail market to all remaining customers, including households. This is planned to commence from 1 January 2001 with detailed transitional arrangements to be developed and announced in due course. On completion of this stage, both the wholesale and retail electricity markets will be fully competitive.

## Gas

Reforms to access arrangements have led to a significant reduction in the price of gas. IPART's (17 July 1997) determination of AGL's proposal for providing third party access to its gas distribution system provides for:

- ◆ a 60 percent reduction (in real terms) in the cost of transporting gas. Average charges per gigajoule will fall from \$2.26 to \$1.05 by 1999-2000; and
- ◆ elimination over three years of the cross-subsidy from business customers to households, while keeping price increases to households capped to well below increases in the CPI.

Another benefit of reform is the construction in 1997-98 of a 146-kilometre pipeline interconnecting NSW and Victorian gas pipelines. During the recent crisis of the failure of the Longford plant in Victoria, emergency gas supplies were transported from the Cooper Basin to the Victorian network via this link. Duke Energy International has recently acquired the rights to develop and operate an 800 kilometre pipeline from Longford to Sydney. They plan to begin construction by July this year and to have gas flowing before September 2000. This will provide security of supply between the two states and greatly enhance the development of a national gas market.

## *Road Transport*

The National Road Transport Commission was established to develop and implement reforms in six agreed areas: uniform heavy vehicle charges, uniform arrangements for transportation of dangerous goods, national driver licensing, national heavy vehicle registration, uniform vehicle operations standards, and consistent compliance and enforcement arrangements.

New South Wales implemented the heavy vehicle charges and the associated permit reforms by State legislation on 1 July 1996 and is progressing with the required reforms under the timetable agreed at the November 1997 meeting of the Ministerial Road Council on Road Transport. The NCC determined that the State had complied with its first tranche road transport reform commitments.

## *Water*

Water reform objectives are based on the February 1994 COAG Strategic Framework for Water Reform. They emphasise pricing reform on the principles of linking charges to consumption, full cost recovery and the reduction or elimination of cross-subsidies. Where subsidies remain, they must be made transparent. Apart from pricing, the framework involves the clarification of property rights, the allocation of water, institutional reform and public consultation and participation.

Pricing reform in metropolitan New South Wales has resulted in savings to non-residential customers of \$63 million since 1995. This represents a saving of approximately 20 percent in real terms. A further \$40 million will be saved over the next two years.

With respect to residential customers, total costs have increased slightly since 1995 (4.7 percent in real terms). This is mostly attributable to an increase in variable costs. Variable costs are those costs directly related to the consumption of water, whereas fixed costs are associated with service provision. The rise in variable costs is consistent with the NSW Government's water conservation policy since higher consumption charges should reduce waste.

## **8.3 OTHER MICRO-ECONOMIC REFORM ACHIEVEMENTS**

### **Performance of NSW Government Businesses**

NSW Government businesses have substantially improved their operational efficiency, financial performance and the level of service they provide. The benefits of economic reform are evident across the spectrum of GBEs. Since 1991-92, the weighted improvement in labour productivity for NSW GBEs has been 94 percent. In addition, between 1994-95 and 1998-99 the NSW Government Charges Index (GCI) fell by almost 12.9 percent in real terms. (The GCI measures the weighted change in prices of the most significant GBEs). Dividends remitted by GBEs to the Government have almost doubled in real terms since 1991-92 to over \$1.4 billion in 1997-98.

## Progress in Implementing Financial System Inquiry (FSI) Reforms

The Federal Treasurer presented a *Statement on the Reform of the Australian Financial System* to the Commonwealth Parliament in September 1997, as the Commonwealth Government's formal response to the FSI.

A key proposed reform in the Statement related to the transfer of prudential and corporate regulatory responsibility for building societies, credit unions and friendly societies from the states/territories to the Commonwealth. Transfer would be effected through the establishment of two major national regulatory bodies, namely: the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

The Prime Minister wrote to Premiers seeking co-operation and support. The Acting Premier of New South Wales responded in January 1998 indicating in-principle support, subject to resolution of a number of issues, including the need for APRA's headquarters to be located in Sydney. The Prime Minister's response in March 1998, indicated that APRA headquarters would be located in Sydney and proposed:

- ◆ early introduction of legislation to provide for the first stage of reforms to be in place from 1 July 1998, including establishment of APRA (this Stage 1 legislation was passed in June 1998); and
- ◆ interim arrangements for the establishment of ASIC, because of the need for changes to the Australian Securities Commission Act and agreement of the Ministerial Council for Corporations (MINCO).

A Commonwealth/State Working Party would develop the necessary administrative and legislative requirements for transferring prudential regulatory responsibilities from the States to the Commonwealth. Proposals emanating from the Working Party could then be considered by the respective jurisdictions as part of the process of determining whether to proceed with the 'in principle' support given in early 1998.

At its first meeting in April 1998, the Working Party agreed to develop a Framework Agreement to enable "in principle" endorsement of the key legislative and administrative proposals. Finalisation of the Framework

Agreement was delayed by the Federal Election and as a consequence endorsement of the States and Territories was not achieved until early 1999.

During this process the Commonwealth (and FINCOM in New South Wales) consulted with the peak industry bodies representing building societies, credit unions and friendly societies on the options and proposed approach for the transfer of prudential supervision responsibilities to the Commonwealth. The NSW Government did not endorse the Framework Agreement until it was satisfied that the proposed transfer mechanisms were fully supported by these groups.

The States and Territories are currently drafting the necessary legislative changes to enable the transfer to proceed on 1 July 1999. The achievement of this date will be dependent upon all states having their legislation passed in this timeframe. New South Wales passed the necessary legislation in late May 1999.

## **Infrastructure**

The provision and management of infrastructure assets have traditionally rested with government, however the significance of private sector investment is gradually increasing. In most cases, private sector involvement reduces the funding burden for the state and improves the efficiency of infrastructure investment and operation through:

- ◆ equitable sharing of risks between the private sector and the government;
- ◆ a market-based approach to investment decisions;
- ◆ cost reflective pricing;
- ◆ greater response to consumer preferences; and
- ◆ a commercial culture with strong pressures for efficiency gains.

Much of the increased private sector involvement in New South Wales has involved Build, Own, Operate and Transfer (BOOT) projects. BOOT projects are schemes where the private sector builds, owns, operates and

then transfers the infrastructure, usually after 20 years, to the public sector. They are a form of structured financing with contractual relations based on equitable risk sharing. New South Wales has contracted nearly \$5 billion in BOOT projects providing transport, electricity, water and sewerage infrastructure.

In 1996, the Government issued *Guidelines for Private Sector Participation in the Provision of Public Infrastructure*. The broad policy is that:

- ◆ involvement of the private sector must show a net benefit;
- ◆ risks and returns must be appropriately shared between the Government and the private sector; and
- ◆ preference is given to projects which are financially free standing without any Government capital contributions.

## **Load Based Licensing**

In late 1997, the Government gave approval for the Environment Protection Authority to prepare a Regulatory Impact Statement (RIS) to assist introduction of a Load Based Licensing (LBL) Scheme. LBL is a performance-based pollution regulatory regime. It contrasts with the current regulatory approach in two main areas.

Firstly, it limits the overall load of pollutants released to the environment (the current scheme focuses on concentration levels). A concentration focus fails to effectively regulate overall pollution loads. LBL will retain concentration limits where required to prevent acute localised impacts.

Secondly, it applies the 'polluter pays' principle. LBL rewards licensees who emit less than their maximum loads. The Scheme also allows for fee rebates to be applied where licensees make specific commitments to reduce emissions by a future date or where they adopt effluent re-use practices.

Other advantages include licensees being afforded maximum flexibility to implement least-cost pollution control measures and polluters bearing the administrative costs of regulating emissions.

It is proposed that LBL will initially apply to the more significant pollution activities covering 80 classes of economic activity and 3,500 licenses.

While the LBL Scheme has been approved for commencement in July 1999, the Government announced a range of changes to the Scheme in response to industry feedback to the RIS. These include:

- ◆ an initial year of estimating loads with no load fees payable, meaning that no load fees will be payable before September 2001;
- ◆ larger rebates of up to 100 percent for licensees who commit to 3-year load reduction agreements, allowing licensees to use their funds for environmental improvement instead of paying fees; and
- ◆ provision of refunds of administration fees where the actual activity level is significantly less than licensed capacity.