PUBLIC
INTEREST
ADVOCACY
CENTRE

Level 1
46-48 York Street
Sydney NSW 2000
Australia
DX 643 Sydney
Tel: (61) (2) 9299 7833
Fax: (61) (2) 9299 7855
Email: piac@fl.asn.au
ACN 002 773 524

Submission to Senate Select Committee on Socio-Economic Consequences of National Competition Policy

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Contact
Stephen Rix
Principal Policy Officer
02 9299 7833 Phone
02 9299 7855 Fax
Stephen_Rix@fcl.fl.asn.au

Executive Summary

1. Reflecting PIAC's focus and priorities, our Submission deals primarily with the following Terms of Reference:

- social welfare
- equity
- environmental impacts; and
- clarification of the public interest.

2. The Submission argues that the wholesale application of competition-based strategies of reform will continue to be questioned in Australia, as elsewhere.

3. We argue that the Committee has a responsibility to ensure that the National Competition Council (NCC) is fully conversant with Australia's constitutional system of democratic governance and that the NCC does not attempt to constrain that system.

4. Both the President of a major labour federation and "the man who beat the Bank of England" agree that market-based policies do not tend towards equilibrium or towards equitable distribution of benefits.

5. National Competition Policy (NCP) was introduced as part of a suite of policies, not as a stand-alone application of competition-inducing mechanisms. The absence of any one of the conditions which were supposed to accompany the introduction of NCP will prejudice the social goals which this suite of policies was supposed to achieve. This is an issue which should be examined closely by the Committee when considering the application of NCP.

6. The Australian Government should undertake a radical recasting of Australian economic policy which would match that being proposed by the Prime Minister for other nations in our region.

7. The terms of the NCP make it incumbent on those who do not ascribe to market "faith" to advocate moderating the policy. Given the dominance of senior policy positions is all jurisdictions by those who hold to "the faith" this is a large and often impossible task.

8. For utilities, each jurisdiction has its own constellation of regulatory agencies for each of the utility industries. This creates confusion and uncertainty for both consumers and industry in their dealings with the utilities. Additional complexity is emerging as a result of technological developments which are resulting in "multi-utilities".

9. The Sydney water event has indicated that a "pure" model of corporatisation is not appropriate for enterprises which deliver essential services, and that the state should have the power to directly intervene in

the operations of private corporations which have the responsibility for delivering essential services.

10. When making final decisions on implementation full retail contestability in the electricity industry, jurisdictions will need to consider wherther their decisions could result in the NCC recommending that they be penalised for failing to implement NCP by having their competition policy payments reduced.

11. The social dimensions of the technical issues of full retail contestability in the electricity industry are contained in the answers to the following questions (amongst others):

- internationally, whose experience is most relevant to the Australian electricity market?
- what are the implications of deciding whether to demand individual metering and or permit load profiling for domestic consumers?
- who should be the supplier of last resort in a fully competitive market, and how will this look?
- what are the jurisdictional issues to be resolved in a move to a national, contestable market for electricity?
- what Community Service Obligations (CSOs) will still have to be delivered and how will this be organised?

12. Most of the social issues which are raised by the introduction of full retail contestability emerge when considering whether metering or load profiling should be used as the tool to measure consumption; and whether customers actually want full retail contestability.

13. Metering is the more accurate but the more expensive option. Profiling also leaves cross-subsidies between different classes of consumers.

14. Deciding whether customers want full retail contestability is also difficult to judge. Evidence from markets where it has been introduced shows that residential consumers are reluctant to enter a competitive market unless their lifestyle (largely income determined) allows them to take advantage of the way in which price competition normally works. It is mainly those who can afford systems which permit them to set appliances to operate when prices are low who obtain most advantage (eg setting the washing machine to operate in the early morning). Most consumers are not in this position. It is also only the well-off who can afford meters which make full retail contestability most attractive.

15. Supplier of last resort issues may emerge as one of the least tractable issues to be resolved in the move to full retail contestability, as the Victorian Office of the Regulator General (ORG) has recognised[1].

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[1]Office of the Regulator-General, Victoria (1998) *Full Retail Competition in the National Electricity Market*, February

16. In its June 1997 Report (*Cultivating Competition*) the House of Representatives Standing Committee on Financial Institutions and Public Administration recommended that a uniform definition of CSOs be developed (page 30). It is extraordinary that such a recommendation would be considered necessary two years after NCP was adopted.

Legislative Review

17. Fundamental Review of NSW Financial and Annual Reporting Legislation

Comments made in our Submission to this review reflected our concern that the institutional perspective informing the review was seriously deficient in that it reflected an inadequate understanding of the nature of Westminster.

18. Review of the Legal Profession Act 1987.

This example shows that, when done properly, NCP can provide an opportunity for positive proposals for change to come forward.

19. Concurrent Review of the Fertilisers Act 1985, Stock (Chemical Residues) Act 1975, Stock Foods Act 1940, Stock Medicines Act 1989 and Part 7 of the Pesticides Act 1978'

We pointed out in our Submission to the Review that the potential threats posed by these chemicals dictates that health, safety and ESD must be paramount considerations in making any recommendation for reform. These are matters included in section 1(3) of the CPA. We also emphasised the unwarranted guiding principle for the review of legislation set by section 5(1) of the CPA.

We higlighted the uncertainties and confusion characteristic of some aspects of NCP implementation; as well as highlighting some of the ways in which NCP is not appropriate to the circumstances in which it is being applied. In addition, it highlights that achieving national consensus which serves the public interest can be problematic.

1. Introduction

The Public Interest Advocacy Centre (PIAC) welcomes the Senate's initiative in establishing the Select Committee on the Socio-Economic Consequences of the National Competition Policy. PIAC has had extensive involvement in National Competition Policy from its inception which is reflected in this Submission.

PIAC was established some 15 years ago to undertake public interest test-case litigation and policy work which has the potential to impact on, and promote, the interests of the broader community.

It works, not by seeing numbers of people individually, but by strategically targeting legal and policy work to benefit as large a group of disadvantaged people as possible. Strategies used include test cases, representative proceedings and *amicus curiae* ('friends of the court') interventions on behalf of, or with the potential to effect, hundreds of individuals.

Areas of work identified in our Strategic Plan include:

- to make the legal system more accessible, fairer and just for disadvantaged people in public interest matters;
- to make the governmental system more transparent, participatory, responsive and accountable for disadvantaged people;
- to redress and reduce institutional abuse and make community services more responsive and accountable for disadvantaged people;
- to ensure that utilities are accessible, responsive and accountable to citizen, consumer and community interests, especially to disadvantaged people;
- to promote better health outcomes through public access to information, especially for disadvantaged people; and
- to seek redress or reform on behalf of citizens, consumers and communities, especially disadvantaged people, in public interest matters.

Reflecting PIAC's focus and priorities, our Submission deals primarily with the following Terms of Reference:

- social welfare
- equity
- environmental impacts; and
- clarification of the public interest.

We have interpreted this last matter very broadly, and have taken it to include the practice of democracy in our Parliamentary system. As will become clear in the Submission, we have identified a number of points where the implementation of National Competition Policy could threaten democratic values and practices, and we are particularly concerned that the Committee closely examine these matters.

We commence with a discussion of the policy environment in which National Competition Policy is being implemented.

2. Policy Environment

> That faith [in the market] represents a significant departure, by both major parties, from support for the post-war welfare state. It has left many Australians feeling confused or betrayed[2]

The economic downturn in Asia, and the impact of economic crisis in eastern Europe, is forcing an international re-assessment of market-based economic policies designed to create economic growth and stability.

See PSRC Introduction page 3 and PSDRC *Postal Services* page 14

This re-assessment has a number of manifestations which include:

- a willingness to reconsider expansionary Keynesian policies (direct state intervention in the economy) in some western European nations;
- re-imposition of exchange controls by some of the most seriously affected of the Asian economies;
- support for exchange controls expressed by the Governor of the Reserve Bank of Australia; and
- an admission by the IMF that its policies, imposed on the Asian economies during the first months of their crisis, actually exacerbated the crisis.

See PSRC Introduction page 4

More directly, decisions made by Australian Governments to reject recommendations made in reviews of some legislation and public enterprise arrangements indicate that a re-assessment of the faith in the market is also occurring amongst Australian political and economic thinkers.

The information herein goes some of the way to explaining why that is so, providing information which indicates serious weaknesses in the implementation of National Competition Policy. This Submission argues that the wholesale application of competition-based strategies of reform will continue to be questioned in Australia, as elsewhere.

3. Governance

> ... for the purposes of assessing compliance with National Competition Policy agreements, the Council takes the agreements as binding not only on the jurisdiction's government but also its parliament, particularly as governments change over time. We therefore expect the government to ensure that the parliament passes all appropriate reforms[3]

At the most general level, some comment on the view expressed by the National Competition Council (NCC) as to how decisions are to be made on implementing National Competition Policy (NCP) is required. The

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[2]Rix, S (1997) *Background paper on community participation in pro-competition legislative review*, PIAC

[3]National Competition Council (1997) *Annual Report*

simple fact is that the NCC misunderstands the principle of the separation of powers which underpins Australian representative democracy.

It is definitely NOT the role of Parliaments to implement Government policy. Rather, Parliament's role is to monitor the performance of the Executive (Cabinet, Departments and other agencies) as they implement policy and expend monies appropriated in Budgets. The Legislature also has the power to amend or reject policy proposals and implementation plans put by the Executive.

The NCC's position is that because major parties were in Government in some jurisdictions, and in Opposition in others, at the time NCP was developed, all parties have a responsibility to ensure that a policy developed at a particular time is implemented in full. This is not only Constitutionally nonsensical, it would also constrain democratic behaviour.

The Committee, as an institution established by Parliament, has a responsibility to ensure that the NCC is fully conversant with Australia's constitutional system of democratic governance and that the NCC does not attempt to constrain that system.

4. National Competition Policy and the economic crisis

HOWARD'S PLEDGE NO RECESSION[4]

4.1. International perspective

See PSRC "The broader socio ..." page 6

The World Economic Forum is an international organisation of the world's political, economic and social elite. It meets regularly at Davos in Switzerland. These "Davos Conferences" are designed to permit the free exchange of views between these elites. Conference proceedings are also reported by the world's media.

In what one commentator called "roughly 70% of the world's daily output of self-congratulation"[5], two speakers spoke out against the application of market-based policies to each and every situation. These were John J. Sweeney President of the AFL-CIO and George Soros.

Sweeney acknowledged the US as an economic success story. He went on:

> But, most working people in the United States today labour longer and harder simply to hold their own; one in four children is born in poverty; one in five workers goes without health insurance. The blessings of prosperity have been largely captured by the few.
>
> At the moment, the workers get the austerity and little else. The speculators get the prosperity.[6]

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[4]Banner, *Sydney Morning Herald*, 1 September 1998
[5]*Financial Times*, quoted by Lewis Lapham, The World Economic Forum and the Magic Mountain, ABC Background Briefing, 5 July 1998 (and repeats)
[6]Quoted in Lapham op. cit.

Lewis Lapham paraphrased George Soros as saying that *only fools and tenured professors of economics believed in the conscience of markets.*

So, both the President of a major labour federation and "the man who beat the Bank of England" agreed that market-based policies do not tend towards equilibrium or towards equitable distribution of benefits. And their comments covered both a national economy which, compared to Australia, has a low level of international exposure; and the international economy.

4.2. National developments

On 30 June 1995 the Competition Policy Reform Bill was introduced into the House of Representatives by the Assistant-Treasurer. It is worth recalling that in the Second Reading Speech, the Assistant-Treasurer said:

> These reforms affirm the role of competition policy as an explicit element of the broad range of considerations the federal government brings to policy decisions; complementing social justice objectives delivered through comprehensive social security and community services programs; protection for consumers, employees and the environment through specific laws; industry development through infrastructure investment and business assistance programs; and stable macro-economic policy settings which maximise the rate of sustainable economic growth.

NCP was introduced as part of a suite of policies, not as a stand-alone application of competition-inducing mechanisms. It is reasonable to assume then, that the absence of any one of the conditions or other policy mechanisms which were supposed to accompany the introduction of NCP will prejudice the social goals which this suite of policies was supposed to achieve.

This is an issue which should be examined closely by the Committee when considering the application of NCP. Here, we simply wish to highlight that maximising the rate of sustainable economic growth has become a problematic exercise in Australia.

It is noteworthy that in a speech on 22 October 1998, the Prime Minister supported the notion of direct fiscal expansion, and improved (ie stronger) regulatory mechanisms in Asian economies to invigorate those economies. He said:

> Regional economies in recession must not be allowed to contract any further than they already have. Domestic demand must be encouraged. The plight of the poorest must also be taken into account - an issue which the World Bank and the IMF have recognised through the relaxation of fiscal targets.[7]

It is now time for the Australian Government to admit that the Australian economy is exhibiting signs of forthcoming recession (if not worse). These signs include a downturn in business confidence and, more substantially,

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[7]The Hon John Howard, MP, Prime Minister of Australia, Address *by the Prime Minister to the10th International Conference of Banking Supervisors,* Town Hall, Sydney

declines in the building and construction industry[8]. Such an admission should be accompanied by a radical recasting of Australian economic policy which would match that being proposed by the Prime Minister for other nations in our region. Part of this radical recasting must be a more sophisticated approach to the application of broad-brush policies (such as NCP) to specific cases.

It may be argued that NCP, when its application includes the public interest test, is configured to achieve just this outcome.

However, there is evidence to suggest that the opposite is the case: NCP is applied in a range of cases where specific conditions have not been considered. The terms of the NCP make it incumbent on those who do not ascribe to market "faith" to advocate moderating the policy. Given the dominance of senior policy positions in all jurisdictions by those who hold to "the faith" this is a large and often impossible task.

The remainder of this Submission outlines where the application of NCP has had, or threatens to have, a socially-negative outcome.

5. Utilities

See PSRC *Compettive Neutrality* page 7 and PSRC *Electricity* page 16

Utilities are subject to NCP in a number of ways. First, their legislation and the legislation which establishes their regulation, is being reviewed; second, the competitive neutrality principle is being applied to government owned enterprises, many of which are utility service providers; and, third, there are specific utility-oriented elements of NCP.

In this section we briefly examine some of the results of NCP as applied to various utilities.

5.1. Electricity industry

5.1.1. Structural issues: regulatory arrangements

Structural changes occurring in the electricity industry are happening against a backdrop of jurisdictional regulatory differences and territoriality which provides no long-term basis for consumers to believe that their interests will be protected.

In NSW alone, the following are some of the bodies which have a regulatory role in the restructuring of the industry:

- the Minister for Energy (licensing);
- the Department of Energy (code development and a licensing role);
- IPART (price regulation, and consideration of full retail contestability);
- Department of Fair Trading (code development);
- Electricity Supply Association (code development);

[8]Robert Harley *Builders braced for high-rise downturn* in Australian Financial Review, 22 October 1998

- National Electricity Market Management Company (rules for the operation of contestable markets);
- National Electricity Code Authority (national rules for the electricity industry);
- Australian Competition and Consumer Commission (oversight of arrangements for a national market);
- Energy Industry Ombudsman of NSW (complaints mechanism); and
- License Compliance Advisory Board (performance monitoring).

This approach indicates an absence of transparency, accessibility or responsibility. Viewed from a national perspective, the situation is worse. Each jurisdiction has its own constellation of regulatory agencies for each of the utility industries. This creates confusion and uncertainty for both consumers and industry in their dealings with the utilities and the regulators. In an environment of limited resources it also stretches the capacity of consumer and community groups to access and influence policy makers and regulators. It is true that institutions such as the Energy Industry Ombudsman provide a site for complaint handling about service delivery, but the overweaning reality is that the ability to influence the overall policy environment is reduced. Moreover, additional complexity is emerging as a result of technological developments which are resulting in "multi-utilities".

5.1.2. Structural issues: corporatisation

The Competition Principles Agreement (CPA) states that *the Parties will, where appropriate, adopt a corporatisation model for ... Government Business Enterprises.* [Clause 3 (4)(a)]. Corporatisation is a strategy designed to reduce the level of political involvement in the operations of these agencies. The idea is that corporatisation would create public institutions which operate as if they were private businesses, with a large degree of managerial autonomy while a set of institutions would be established to ensure that the agencies operated effectively in achieving the goals which were set for it (eg supplying safe drinking water). These institutions would be license compliance boards and similar. The purpose is to reduce the potential for direct Ministerial involvement in the enterprise's operations which could impact on the commercial operations of the enterprise. In NSW, the legislative instruments for achieving this goal are the *State Owned Corporations Act (NSW) 1989* and the *State Owned Corporations Amendment Act (NSW) 1995.* [9]

In March 1997 the NSW Government provided, as required, *Report to National Competition Council on the Application of National Competition Policy in NSW for the period 1995-97.* Table 1 of that Report showed which state-owned enterprises had been corporatised. Amongst these enterprises were the Hunter Water Corporation and the Sydney Water Corporation.

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[9] See *NSW Government Policy Statement in Competitive Neutrality* June 1996.

The process of corporatisation was touted as something new and innovative. However, Pat Troy, Clem Lloyd and Susan Schreiner showed that, far from being innovative, such structural changes took the Hunter Water Corporation back to the form it was in a century earlier:

> The Hunter District Water Board began its existence as a Government Business Undertaking in 1892. A hundred years later, as the Hunter Water Corporation, it was described officially in the jargon of the 1990s as a Government Trading Enterprise. page 317[10]

There are signs that the hundred-year-cycle which Hunter Water Board went through is repeating only much more quickly[11].

Beginning in late July 1998, residents in Sydney experienced what has become known to some as "the Sydney water crisis" and to others as "the Sydney water event". The evidence indicates that communication between Sydney Water Corporation, NSW Health, and their respective Ministers was poor, and that communication with the public revealed "significant flaws".

The Sydney Water Inquiry, which was established to examine and report on the causes and course of the "crisis", concluded that:

> The arrangements relating to the management of Sydney Water as a State owned corporation should be reviewed to ensure that the Minister has sufficient power to obtain information from the corporation and if circumstances require, give direction which is necessary in the public interest[12].

This recommendation has been accepted by the NSW Government in the form of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Bill 1998* . This Bill would convert Sydney Water Corporation and Hunter Water Corporation to statutory SOCs rather than company SOCs under the State Owned Corporations Act.

The Bill would also insert provisions into the relevant Acts:

> ... that enable the portfolio Minister to give the new statutory corporation a direction in the public interest under section 20P of the *State Owned Corporations Act 1989,* without the necessity of consulting the board of the corporation and requesting its advice as to whether the direction would be in the best interests of the corporation. This action will be taken if the Minister decides that it is warranted on grounds involving urgency, public health or public safety. A statement of reasons will be required to be published (from *Explanatory Note,* page 6).

The Bill would also, by amending the *Public Health Act,* give Health (in various forms) the power to issue general advice and a "boil water advice" regarding water supplied for drinking by a *supplier.* A *supplier of drinking water* (or *supplier)* [Schedule 1, Part 2A] is defined as Sydney Water

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[10]Pat Troy, Clem Lloyd and Susan Schreiner (992)*For the Public Health. The Hunter District Water Board 1892-1992*

[11]The cyclical nature of so-called public sector reform is nowhere better documented than in Justin Macdonnell's history of federal arts institutions *Arts,, Minister?* (Currency Press)

[12]Sydney Water Inquiry (Peter McClellan QC) (1998) *Second Interim Report: Management of the Events* (September) page 79

Corporation, Hunter Water Corporation, local government water suppliers etc and:

> (h) any person supplying drinking water in the course of a commercial undertaking (other than that of supplying bottled or packaged drinking water), being a person who has not received the water:
>
> > (i) from a person referred to in any of the preceding paragraphs, or
> >
> > (ii) in the form of bottled or packaged water.

Put simply, the Sydney water event has indicated that a "pure" model of corporatisation is not appropriate for enterprises which deliver essential services, and that the state should have the power to directly intervene in the operations of private corporations which have the responsibility for delivering essential services. It proved that the political nature of a failure to provide essential services cannot be extinguished by a change in the structure. It is the nature of the service which makes it political and the structure adopted should reflect that rather than ignore it.

5.1.3. Electricity: full retail contestability

A great deal of energy is currently being expended on developing the conditions for full retail contestability in the electricity industry. This follows the extension of full competition into the electricity industry in other, larger markets. The most recent sector to be made contestable was the 160MWh/year market.

The extension of competition into the residential and small commercial electricity market is supposed to provide all the advantages of a competitive market to these electrical energy consumers.

However, there is significant doubt about whether full retail contestability can or will be introduced. A major issue for State governments to consider when making final decisions is whether failing to implement full retail contestability could result in the NCC recommending that the States (and Territories) be penalised for failing to implement NCP by having their competition policy payments reduced.

The reason for this pessimism on full retail contestability is explained by considering the social dimensions of the technical issues associated with full retail contestability.

The social dimensions of the technical issues are contained in the answers to the following questions (amongst others):

- internationally, whose experience is most relevant to the Australian electricity market?
- what are the implications of deciding whether to demand individual metering and or permit load profiling for domestic consumers?
- who should be the supplier of last resort in a fully competitive market, and how will this look?
- what are the jurisdictional issues to be resolved in a move to a national, contestable market for electricity?

- what Community Service Obligations (CSOs) will still have to be delivered and how will this be organised?

Internationally, competition in the residential market is being introduced in a variety of ways. Some of these are:
- in California full retail contestability was introduced in a "big bang" 31 March 1998;
- New Zealand also went with a "big bang" approach; and
- New York is introducing full retail competition in tranches.

It is difficult to determine which of these examples is most relevant to Australia. For example, it may be considered that California is the most relevant. However, the implications of California's position as simply one State in a federation are not clear. On the other hand, California's market is, on its own, larger than Australia's though distances are not so great. New Zealand is a unitary state and has a very small population; and New York has its peculiar characteristics which need to be borne in mind.

System operation, market administration and settlement responsibility decisions offer a similar number of international experiences from which to draw. In California, there is a an independent system operator and a wholesale power exchange; while Scotland has two vertically integrated companies which perform all functions .

But most of the social issues which are raised by the introduction of full retail contestability emerge when considering whether metering or load profiling should be used as the tool to measure consumption; and whether customers actually want full retail contestability.

Put simply, metering is the more accurate but the more expensive option. Profiling also leaves cross-subsidies between different classes of consumers.

Deciding whether customers want full retail contestability is also difficult to judge. Evidence from markets where it has been introduced shows that residential consumers are reluctant to enter a competitive market unless their lifestyle (largely income determined) allows them to take advantage of the way in which price competition normally works. It is mainly those who can afford systems which permit them to set appliances to operate when prices are low who obtain most advantage (eg setting the washing machine to operate in the early morning). Most consumers are not in this position. It is also only the well-off who can afford meters which make full retail contestability most attractive.

It is also problematic whether the retail margins which exist in the electricity industry are sufficient to provide the benefits which are said to flow from competitive market structures. For example, consultants engaged by IPART in NSW reported that:

> Some preliminary market research from New Zealand suggested a saving of about $10 per month, plus or minus $5, is needed to motivate customers to change retailers. In the USA, market research found customers would switch for $US100, or 10% to 15% of their annual bill. Some private Australian research suggested a 15% to 20% saving annually, or about $120 to $160 annually, is required to motivate customers to just <u>consider</u> changing retailer.
>
> The research suggests residential customers will need to save over $100 before they will change retailers. As energy and distribution costs make up over 85% of the average $800 annual residential bill, this implies the $100 savings must come from the remaining approximately $100 retail component of their bill. This would eliminate the entire retail component of the bill and effectively means retailers will never be able to offer a sufficient incentive for the average residential customer to consider changing retailers[13].

In addition (as is the case the mobile phone market) pricing strategies are likely:

1. to make direct comparison difficult for individual consumers; and
2. to require almost constant comparison to ensure that the choice of supplier remains optimal over time.

Nationally, the consultant's report prepared for the National Electricity Market Management Company's Metering and Retail Settlements Steering Committee (NEMMCO MARS Committee) is an extremely detailed document outlining the international experience of full retail contestability. It is, however, very weak on the regulated protections which are, or could be, provided to residential consumers in a competitive residential electricity market.

The rationale for this absence is their view that these social issues are best dealt with after the system is designed. The consumer representative on the MARS Committee has consistently opposed this view, arguing that unless the system is designed with all consumers in mind, any mechanism put in place to protect consumers is likely to be a patch[14] . The consumer representative commented to the consultants:

> I have repeatedly argued that some of the issues which the majority of the MARS Committee consider to be second-order issues are, in fact, threshold consumer issues.
>
> For instance, the Warwick Business School study cited in the report indicates that the benefits from competition are only enjoyed by those who have the resources to enter the market fully-fledged (the affluent). This is not acceptable from a consumer perspective ....[15]

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[13]SRC International (1998) *Draft Report prepared for Independent Pricing and Regulatory Tribunal <u>Contestability for Residential and Other Low Use Electricity Customers</u>*, August, page 42

[14]Putnam, Hayes and Bartlett - Asia Pacific Pty Ltd & Lacuna Consulting Ltd (1998) *Draft Report <u>Development of a Conceptual Metering and Settlement Design for Full Retail Competition in the National Electricity Market</u>*, Prepared for the National Electricity Market Management Company Metering and Retail Settlement Steering Committee, August

[15]NEMMCO MARS Committee (1998) *Comments from Stephen Rix, CFA on Full Contestability Stage 1 Report Produced by PHB/Lacuna* , August

Finally, it is also doubtful whether competitive structures are required to drive price in the desired direction. For instance, the Electricity Supply Association of Australia (ESAA) reported in October 1998 that:

> In Tasmania, where there is not yet a competitive electricity market, industry electricity price is also falling dramatically. According the new published tariffs, electricity prices for industrial customers in 1997 will be reduced by more than 12 percent.

It is worth bearing in mind that this price reduction has been achieved without any of the transaction costs (ultimately borne by consumers) of moving to a competitive market. There are those who will argue, rhetorically, that the Tasmanian price has had to fall in order to maintain Tasmania's competitive position *vis a vis* the mainland market. However, such an argument does not confront the substantive issue that price could also have been driven down on the mainland by political decision.

Supplier of last resort issues may emerge as one of the least tractable issues to be resolved in the move to full retail contestability, as the Victorian Office of the Regulator General (ORG) has recognised[16].

Rather than consider CSOs in the evolving electricity industry in isolation, the following section outlines some of our concerns in general terms.

5.1.4. Community Service Obligations

See PSRC *Competitive Neutrality* page 9

The 1995 CPA contained the following:

> 4(3) Before a Party introduces competition to a market traditionally supplied by a public monopoly, and before a Party privatises a public monopoly, it will undertake a review into:
>
> > (f) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations.

By 1997, the House of Representatives Standing Committee on Financial Institutions and Public Administration in its June 1997 Report (*Cultivating Competition*) recommended that a uniform definition of CSOs be developed (page 30). It is extraordinary that such a recommendation is still considered necessary two years after NCP was adopted.

As Professor Bob Walker said at a conference in December 1997:

> The concept of 'community service obligations' has been the subject of debate on the literature of public sector administration for more than half a decade. The concept has also been applied in practice by several Australian governments, so there is now a body of experience which can be drawn upon to assess the way in which the idea of identifying, costing - and, possibly, separately funding - CSOs has worked in practice

More broadly, Walker also pointed out that interest in CSOs was:

> ... essentially based on the assumption that public sector agencies were inefficient, and also reflected the expectation that public sector managers

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[16]Office of the Regulator-General, Victoria (1998) *Full Retail Competition in the National Electricity Market*, February

could not be trusted to drive improvements in efficiency without being subject to crude forms of controls[17].

The following are features which may be considered common to all CSOs:

- they are required by government and that requirement is made explicit;
- no purely commercial enterprise would deliver the CSO, and they would not be delivered as a marketing device;[18] and
- they are funded by government Budgets not from enterprise cross-subsidies.

One of the major public policy rationales for this system is enhanced transparency. The following Table reports an attempt to obtain, from Budget Papers, details of CSOs in the transport sector in NSW. Clearly, those details are not readily available.

Table 1: Transport CSO Payments, NSW Budget Information

Portfolio	**Providing Agency**	**Social Program**	**Budget Funding**			
			1995/96	**1996/97**	**1997/98**	**1998/99**
			$m	**$m**	**$m**	**$m**
TRANSPORT	STA	Pensioner concessions				171.5*
		Ticketing concessions				
		Service Subsidies				
		Student concessions	*330	329.6	345.2	367.8
		TOTAL	**138**	**137**		
	SRA	Pensioner concessions				
		Ticketing concessions				
		Service Subsidies				+80
		Student concessions				
		TOTAL	**421**	**299**		
				* RTA and STA		

[17]Walker, R (1997) *Paper to IIR CSOs Conference,* December

[18]We understand this reference of marketing would exclude such things as discounts provided by cinemas, for example, on a normally slow weekday.

The development of the treatment of CSOs as NCP implementation rolls-out has to be seen in the context of substantive developments in other arenas. In respect of the NSW electricity industry, in 1998 the *Electricity Supply (General) Regulation* was amended to include Social Programs (of which CSOs are one type). The Regulation enables the Minister for Energy (in NSW the Minister retains license authority) to create license conditions for distributors and retailers for delivery of government's social programs. Both distributors and retailers are covered by the new Regulation (Schedule 1, [41]).

In respect of both electricity distributors and retailers any Minister (known as the sponsoring Minister) with the concurrence of the Treasurer can direct the distributor or retailer *to take such action as the sponsoring Minister considers appropriate to facilitate the delivery of any aspect of the Government's social programs for electricity within the sponsoring Minister's administrative responsibility.*

These directions may provide that the services be provided free of charge, at specified charges or subject to specified discounts or rebates; and specify the cost to the **electricity distributor** of providing the service. The Regulation specifies that any direction does not have affect until agreement is reached on the magnitude of the costs is determined. Arrangements for payment of the costs must also be made. No direction can be issued unless discussions have been held between the sponsoring Minister and the company, but no resolution has been reached. The arrangements must be made public.

In respect of **electricity retailers** any direction given by the sponsoring Minister may require *specified classes of customers to be supplied with electricity at discounted charges or to be given rebates on the charges paid by them for the supply of electricity.* The Regulation also empowers the Minister to direct retailers to have fully accountable financial arrangements in place (including trust accounts) to ensure that Government payments made to the retailer are utilised in the manner intended. Similar provisions to those applying to distributors in regard to discussions being held and public announcements are also included.

The Regulation has the effect of institutionalising the principle of Government paying agencies to deliver specified services to special classes of consumers. The alternative of requiring the companies to show the financial impact of implementing social programs, paid for by internal cross-subsidies, at Government behest is not provided for. At the same time, the Government is having a direct impact on the finances of the companies by requiring more and more in the form of dividends and loan guarantee fees which are supposed to emulate the relationship between a privately-owned company and its shareholders.

What is being ignored by policy-makers in the roll-out of NCP is the political component to all these issues.

6. Legislative Review

In this section we present evidence that the legislative review process, at least in NSW, has resulted in challenges which, if delivered, would have seriously negative effects politically and socially. The first of these examples relates to accountability of public sector agencies; the second to consumer protection where services are provided by a profession; and the third to regulation of chemicals use.

6.1. Fundamental Review of NSW Financial and Annual Reporting Legislation

The Fundamental Review of NSW Financial and Annual Reporting Legislation deals with the *Public Finance and Audit Act, 1983*, and two Annual Reporting Acts covering statutory authorities and departments. The *Working Paper* distributed by Treasury's Office of Financial Management (OFM) explains that the purpose of the fundamental review is:

> to create a totally new piece of legislation which provides not only a backing for the financial management and accountability framework now existing in New South Wales but also reflects the philosophy and objectives of the financial management reforms[19].

PIAC prepared a brief Submission to NSW Treasury which outlined some of our concerns with the direction being followed in the review of the legislation, and the preparation of new legislation[20]. The *Public Finance and Audit Act* and the other Acts referred to were listed for review by the NSW Government in its 1996 NSW NCP *Legislative Review Policy Statement.*

Our comments reflected our concern that the institutional perspective informing the review was deficient in that it reflected an inadequate understanding of the nature of Westminster. For instance, the *Working Paper* states that *the essential role of Parliament should therefore be seen as authorising the expenditure of public moneys by the Executive Government within a framework that ensures (or at least promotes) efficient, effective and accountable services* (page 11). Our comment was that *it is misleading to describe [this] as Parliament's essential role.*

We pointed out that the legislature also has a role in overseeing and determining policy positions proposed by the Executive, and that this precedes the Budget role. PIAC sees the tension which exists between the Executive and legislature in our system of government as an expression of democratic principles and an essential protector of rights which have been won over many centuries. We are concerned that if the perspective on the roles of the various institutions reflected in the *Working Paper* is allowed to proceed without demur then we run a risk of implicitly supporting the diminution of those rights. When read in the context of the NCC's view

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[19]NSW Treasury Office of Financial Management [OFM] (1998) *Working Paper: Fundamental Review of NSW Financial and Annual Reporting Legislation,* July, page

[20]PIAC (1998) *Comment on Fundamental Review of NSW Financial and Annual Reporting Legislation,* October

regarding the role of Parliament in NCP implementation, a disturbing trend emerges[21].

We also objected to the *Working Paper*'s characterisation of the Budget process:

> Through its legislative taxing powers, the Parliament authorises the government to acquire substantial resources from one group in the community (ie taxpayers) in order to provide services to another (ie consumers)

We described this statement as *at best, distasteful and at worst misleading.* We pointed out that people (ie citizens) may consume services provided by Government but at least some of those services are provided as a matter of right. That is, there is no market relationship in the provision of those services. Therefore, tax revenues do not necessarily flow from one group in the economy to another. Rather, all citizens contribute by paying tax to the upkeep of institutions which provide a general benefit to all citizens[22]. We referred to the judiciary as a case in point.

The *Working Paper* also makes comment on the Auditor-General's currently restricted access to "documents the subject of legal professional privilege" (page 74). We argued that this needs closer examination to cover those instances where the Auditor requires access to those documents in order to obtain the information necessary to conduct a proper audit.

Finally, we objected to the presumption in the *Working Paper* that commercialisation and corporatisation accountability arrangements should be institutionalised in new legislation. There has never been a conclusive argument that these arrangements are superior to any others (as the Sydney water event shows).

The purpose of commenting on this particular review is not to show what has occurred as NCP has been implemented, but to show what could occur if it is inappropriately implemented.

6.2. Review of NSW Legal Profession Act

In 1998 the NSW Government initiated a review of the *Legal Profession Act 1987*. It is important for us to acknowledge that the Issues Paper produced to facilitate the review was extremely useful[23]. As a legal centre, PIAC produced a Submission to the review[24].

In our Submission we made the following introductory comments:

> The market environment in which legal services are 'bought and sold' is characterised by the following features:

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[21]This also emerged in the Victorian Government's changes to the powers of Auditor-General in that State in 1997.

[22]Though the point was not made in our Submission, the nature of the State's tax base means that all (rich and poor) contribute to the State's revenues.

[23]NSW Attorney-General's Department (1998) *National Competition Policy Review of the Legal Profession Act* , August [3 Volumes and Summary]

[24]PIAC (1998) *Submission to National Competition Policy Review of the Legal Profession Act*, September

- legal outcomes cannot be purchased. That is, the legal consumer can purchase the best available legal service and still not be satisfied with the outcome. In economic terms, a high degree of uncertainty pervades the market;
- there is no direct correlation between a need for legal services and the capacity to pay for them. Access to legal services is increasingly seen as a human right, or as a requirement of a properly operating legal system. Thus, legal services may be construed as an essential service. There are many who also believe that the price of legal services are too high;
- the market does not meet the legal service needs of disadvantaged and marginalised consumers; and
- 'information asymmetry' precludes the operation of a free legal services market. Moreover, most consumers purchase legal services on a rare and irregular basis so there is little likelihood that they will become familiar with the market.

The pervasive economic reality is the lack of funding for the provision of legal services to those most in need. This is not an issue which legislation review is examining, but should inform the approach taken by those responsible for the review.

One of the most significant of our conclusions was that public costs associated with the restrictions on competition in the legal services market could be minimised by re-introducing a schedule of fees. It is instructive to reflect on the fact that the fee schedule was removed some years ago in order to create a more market-oriented relationship between legal services consumers and legal services providers. But the very nature of the market, where the provider has significantly greater market power than the consumer, means that a market relationship on fees (ie price) does not work.

We also argued that the lawyer's duty to the public (which forms part of the Code of Ethics) should be formalised by some form of mandating of services provided *pro bono*. In recognition of the fact that sections of the legal services market have already been opened to some form of competition (eg property conveyancing) we also argued that the non-lawyer providers should also be required to undertake *pro bono* work (the principle of competitive neutrality underlay this conclusion).

This example shows that, when done properly, NCP can provide an opportunity for positive proposals for change to come forward.

6.3. Concurrent Review of Agricultural and Veterinary Chemicals Control-of-Use Legislation in NSW

In April 1998 NSW Agriculture circulated an *Issues Paper* providing background for the 'Concurrent Review of the Fertilisers Act 1985, Stock (Chemical Residues) Act 1975, Stock Foods Act 1940, Stock Medicines Act 1989 and Part 7 of the Pesticides Act 1978'. These Acts are known collectively as "agvet chemicals control-of-use" Acts. Other jurisdictions have similar legislation known called 'Control-of-Use Acts'.

In May 1998, PIAC contacted NSW Agriculture expressing concern that *the Review Committee [established by NSW Agriculture] contains no representation from community, consumer or environmental groups* and noting that *the fertiliser industry has a conduit to the Review Committee through a Working Party.*[25] We proposed that a Working Party be established for community, consumer and environmental groups which have a clear interest in the legislation. NSW Agriculture accepted the suggestion, and a Working Group made up of PIAC, the NSW Environmental Defenders Office (EDO) and the Total Environment Centre was formed, and produced a Submission to the Review Committee.[26]

Our Submission contains a Table setting out in tabular form the situation regarding each State's review of control-of-use legislation. We have included that Table here for the Committee's benefit.

Table 2: Review of Agricultural and Veterinary Chemicals Control-of-Use Legislation, Australia

C'th	NSW	Vic	Qld	SA	WA	Tas
National Review of Agricultural & Veterinary Chemicals Act and Regulations	Party to national review, except control-of-use provisions	party to national review including control of use provisions	party to national review including control-of-use provisions	party to national review (registration of chems) except control-of use provisions: stock medicines, stock foods & ag chems; and ag & vet chems	party to national review including control-of-use provisions	party to national review including control-of-use provisions

The Submission points out that *the potential threats posed by these chemicals dictates that health, safety and ESD must be paramount considerations in making any recommendation for reform.* These are matters included in section 1(3) of the CPA. However, we also pointed out that:

> ... we emphasise the unwarranted guiding principle for the review of legislation ... set by section 5(1) of the CPA. In instances where legislation has the critical public health and environmental protection objectives, it is clearly inappropriate to limit their fulfilment to cases where "the objectives of the legislation can *only* be achieved by restricting competition". Theoretical

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[25]Rix, S, Letter to NSW Agriculture, 4 May 1998

[26]Total Environment Centre, Public Interest Advocacy Centre, Environmental Defender's Office Ltd (1998) *Submission to NSW Agriculture on the Concurrent Review of the Fertilisers Act 1985, Stock (Chemical Residues) Act 1975, Stock Foods Act 1940, Stock Medicines Act 1989 and Part 7 of the Pesticides Act 1978 on behalf of the Consumer, Community and Environmental Working Party,* August

alternatives can always be put forward that may in some sense meet the law's objectives but fail completely in terms of objectives.

Experience with a similar provision in Article XX of the General Agreement on Tariffs and Trade (GATT) demonstrates that the use of this guiding principle will elevate the well-being of financial interests and the market over and above the well-being of the health and safety of people, as well as the environment in which they live. This, of course, is against the common good and welfare of the Australian people and their environment and is unacceptable (page 1).

We rejected outright - and in market terms - any suggestion that control-of-use legislation be removed. We pointed out that market participants are not bearing the full costs of their actions (ie there are negative externalities which would not be captured in a pure market environment) and that information asymmetry is a feature of the relationship between sellers and consumers.

One of our first recommendations to the Review was that national arrangements for agvet chemicals control-of-use legislation should be a goal of all Australian governments. We also made it clear that in certain markets legislative regulation has efficiency advantages over a so-called de-regulated market arrangement where the additional costs of regulation through litigation must be considered.

One our key recommendations was that each piece of legislation should include an "objects clause", which they currently do not. The suggested wording of those objects clauses recommendation is repeated in full below.

The Objects of this Act are as follows:

(1) to reduce and eliminate risks to human health and prevent the degradation of the environment caused by the use of [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides].

(2) to reduce to harmless levels the discharge into the air, water or land of [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides] likely to cause harm to human health and safety or to the environment.

(3) to promote the reduction and elimination of the use of [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides] likely to cause harm human health and safety or to the environment.

(4) to promote community involvement in decisions about [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides].

(5) to ensure the community has easy access to relevant information about [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides].

(6) to allocate the costs of the protection of human safety and the environment equitably and in a manner that encourages responsible use of [insert as appropriate: fertilisers, chemical residues, stock medicines, or pesticides] and reduces harm to the environment.

(7) to assist in the achievement of ecologically sustainable development. Ecologically sustainable development can be achieved through the implementation of the following principles and programs:

(a) The precautionary principle - namely, that if there are threats of serious or irreversible environmental damage, lack of full scientific certainty is not a reason for postponing measures to prevent environmental harm.

(b) Inter - generational equity - namely that the present generation should ensure that the health, diversity and productivity of the environment is maintained or enhanced for the benefit of future generations. The principle of inter-generational equity requires that intra-generational equity also be observed.

(c) Conservation of biological diversity and ecological integrity as a fundamental and primary consideration.

(d) Improved valuation and pricing of environmental resources, including but not limited to:

(i) the inclusion of environmental factors in the valuation of assets and services - namely the pricing of goods and services to be based upon a full life cycle assessment of the costs of providing those goods and services, including assessment of the cost of natural and environmental resources utilised or degraded, and the costs of the ultimate disposal of any waste which may be generated;

(ii) implementation of the polluter pays principle - namely producers of pollution and waste to bear the cost of avoidance, abatement, recycling, remediation or containment;

(iii) the pursuit of environmental goals by establishing incentive structures, including market mechanisms which enable those best placed to maximise benefits and/or minimise costs to develop their own solutions and responses to environmental problems.

(e) Recognition that the environmental impacts of actions and policies occur at local, regional and global levels.

(f) Community participation - namely that decision making processes and the formulation of policies, programs and management plans necessarily involve the participation of members of the community, through:

(i) transparency of administrative process and the provision of access to complete information to the fullest extent possible;

(ii) public notification of decision making processes and the formulation of policies, programs and management plans; and

(iii) full consultation and consideration of community input.

In respect of the individual Acts under review, we made the following points (amongst others):

- it is not possible to undertake a benefit-cost analysis of Part 7 of the *Pesticides Act* 1978 because it is not implemented, and that therefore the precautionary principle should be applied and the Act implemented. Only then could any changes be justified;

- because section 50 of the NSW *Pesticides Act* are similar to Part 7 of the *Victorian Agricultural and Veterinary Chemicals (Control of Use) Act,* there should be no amendment made in NSW until the national review, of which Victoria is a part, is completed; and that NSW should reserve the right to reject any national recommendation which would be against the public interest;
- it is not possible to determine whether *Stock (Chemical Residues) Act* 1975 imposes a restriction on competition such that the benefits do not outweigh the costs, and the precautionary principle should again be invoked;
- until a definitional matter raised by us is resolved, it is not possible to offer detailed comments on the *Stock Foods Act* 1940; and
- the information disclosure provisions of the *Stock Medicines Act* 1989 make it entirely inappropriate for this restriction on competition to be removed.

Our Submission to this particular review higlighted the uncertainties and confusion characteristic of some aspects of NCP implementation. It also highlighted some of the ways in which NCP is not appropriate to the circumstances in which it is being applied. In addition, it illustrates that achieving national consensus which serves the public interest can be problematic.

But most importantly, it illustrates that the community, consumer and environmental movements are capable of recognising threats to the public interest, and taking the initiative to protect the public interest.