

**REFORMING PUBLIC ENTERPRISES -- CASE STUDIES
AUSTRALIA**

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Overview of Public Enterprise Prior to Reform

1. Government business enterprises (GBEs) were a dominant part of Australian life until the late 1980s. At that time, GBEs accounted for almost 10 per cent of gross domestic product, and 16 per cent of net capital stock and were the sole suppliers of electricity, water, gas and communication services for most Australians. In addition, all State and territory governments were involved in banking, finance and transport. While the Commonwealth owned and operated Australia Post, Telecom and two airlines, the majority of GBEs were then, and remain now, under State and territory government ownership and management.

2. Distinguishing features of State and territory GBEs were their limitation to within State boundaries, and specialisation within sectors.

3. GBE reform in Australia was essentially a private and individual matter for each government until 1990 when Prime Minister Hawke and New South Wales Premier Greiner combined to establish the Special Premier's Conference (SPC) process. Prior to 1990, each government had adopted and pursued their own agenda of reform and there was little or no interchange or discussion between the various governments. The assembling of all Australian governments to address issues of micro-economic policy under the SPCs and the subsequent meetings of the Council of Australian Government (COAG) has co-ordinated, extended and documented GBE reform. However, observations of key events and drivers in the process of GBE reform prior to 1990 are necessarily personal and selective.

Figure 1.1. Australian GBEs^a Shares in Basic Aggregates¹

	1979-80 %	1988-89 %	1995-96 %
Employment ^b		5.0	5.0
GDP ^c	9.8	10.1	8.3
Net capital stock	17.9	17.4	15.2
Capital Expenditure	16.8	12.2	11.0

a Refers to both public trading and public financial enterprises unless otherwise stated.

b Public trading enterprises. In 1988-89, employment in public financial enterprises represented around 1% of total employment.

c Proportion of Wages, salaries and supplements plus Gross operating surplus to GDP at factor cost.

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4. *Sources:* ABS Cat. Nos. 5204.0 and 5221.0 and Commonwealth of Australia (various) "Budget Statements, Budget Paper No. 1", AGPS, Canberra

5. The extent of reform can be examined by contrasting the range and nature of activities undertaken by GBEs at the beginning of the 1980s compared with the situation in 1997.

Snapshots of GBEs -- Circa 1980

6. **Electricity, gas and water utilities** were owned and managed by the respective State governments. Typically, these utilities were specialised in their sector, vertically integrated, monolithic, benevolent and large employers and combined regulatory with operational functions.

7. For instance, in New South Wales, Elcom mined coal, ran the power stations and the transmission grid, although electricity distribution was the responsibility of more than 20 county councils. In Victoria, the State Electricity Commission (SECV) ran the open cuts, the power stations, the transmission grid and most of the distribution system and was responsible for quality control.

8. Similarly, in the **water sector**, the Sydney Water Board and its counterparts in Melbourne, Adelaide and Perth were totally integrated vertically, covering headworks, mains reticulation and tailworks plus parks and waterways.

9. The **gas sector** was less integrated and less uniform. In most States, private companies were responsible for gas production with the State owning the main distribution pipeline and in Victoria and Western Australia the retail reticulation operation. However, in Sydney, Australian Gaslight was the main distributor.

10. None of these utilities was subject to economic regulation² and indeed most of these utilities set policy and regulation for their industry. Most of these utilities were still in a growth and construction phase, with engineering as the dominant profession.³

11. In **transport**, the Commonwealth owned the airlines Qantas and TAA and, in shipping, the Australian National Line. State shipping services had contracted to servicing Western Australia and Tasmania but all States and the Commonwealth were involved in rail. Ports were generally operated by the States and airports by the Commonwealth.

12. **Communications** were monopolised by the Commonwealth-owned, Australia Post and Telecom.

13. In the **Finance sector**, the Commonwealth and virtually all States owned and operated a government bank, whose origins had been either as a savings or development bank. All States had a State insurance office handling **general insurance** (variously named SIO, SGIC and GIO).

14. Workplace accident compensation insurance was still a private market in each State. The effective nationalisation of workers' compensation under statutory schemes in New South Wales and Victoria did not occur until the mid-1980s.

15. A wide variety of **other activities** -- ranging from public trustees, printing works, produce markets and linen services -- were also undertaken by particularly State governments.

16. The relative importance of GBEs in each sector is indicated in Figures 1.2 and 1.3 in the appendices.

Government Objectives

17. "The origin of many GBEs can be traced back to earlier reservations about the ability of the market to maximise community welfare."⁴

18. Factors prompting Australian governments to establish or take over business enterprises have included:

- the **magnitude and risk** of major developments in a sparsely populated country plus economies of scale and **natural monopoly characteristics** in electricity, gas and water provided the rationale and urgency for Government to establish or take over early rail, coastal shipping and water supply, and later, to develop the large energy utilities in each State.

The magnitude and risk and the need for cross government co-operation also drove the establishment of the Murray Darling Basin Commission and the Snowy Mountains Hydro Electric Authority Corporation;⁵

- **failure of private suppliers** has not, since the 1950s, been a major factor promoting government ownership and business enterprises. Historically, colonial railways, shipping, electricity, gas and water had been privately provided in numerous cases, but had failed financially or were unable to meet the challenge of very rapid growth. Continuation of the service rather than protection of employment in these private firms was the motivating factor; and
- **keeping the private monopolist honest.** "The ground rules for the Australian aviation industry were established following the attempts of the [Commonwealth] government to nationalise the industry, first by outright acquisition and then by subsidised competition from a publicly owned carrier."⁶ The Stated reason of subsequent conservative governments for continuing this arrangement was that the government carrier provided competition to the private carrier.

19. Nonetheless, politically motivated nationalisation has not generally been a significant factor. The Commonwealth Government under Labour had attempted unsuccessfully to nationalise banking in 1948 and in the same period the New South Wales Government nationalised coal mines on a major scale. However, nationalisation was not wide-spread and did not change the boundaries between government and private business enterprises. Indeed, the boundaries between government and private business enterprises in Australia were essentially stable from the 1920s to the early 1990s.⁷

20. In 1987, the Economic Planning Advisory Council summarised the traditional rationale for government involvement in GBEs:

“...Australian governments have chosen to produce goods and services through public enterprises to facilitate the control of natural monopolies, ‘safeguard’ competition in some regulated industries, promote a longer term view of investment needs and opportunities, and facilitate the pursuit of social objectives.”⁸

Legal and Budgetary Arrangements

21. In 1980 the larger Government business enterprises, such as the national airline Qantas, and the Commonwealth Bank, operated as statutory authorities. However, many smaller business activities and some significant operations, operated within the departmental structure. For example, in the NSW Department of Water Resources operated the headworks and major irrigation businesses across the State (and, to a large extent, still does). The relationship of GBEs to the budget was, therefore, variable with minor activities and major activities dependent on ongoing subsidy being reflected within the general government budget. Moreover, the major business enterprises were not consolidated or identified. As a result, budgetary reporting on GBE activities varied widely between governments. Consequently, both the budgetary position of the governments and the financial position of the business enterprises was generally unclear — a situation not rectified until 1987 when the Institute of Public Affairs published for the first time, consistent accounts for all States.⁹

22. While Ministers did not exercise day-to-day control, they were able to exercise considerable control when desired. At the same time, the appointment of independent commissioners, the dominance of the engineering profession, the strong public service ethic and the tradition of benevolent paternalism allowed many of the GBEs to operate with considerable independence and autonomy. Formal monitoring was unknown and specific operating and financial targets, when set, were by negotiation.

23. In aggregate, GBEs were a net drain on the Commonwealth and State budgets, primarily because of losses in transport. In the each of the three years to 1981-82, net payments to the GBEs from the budget sector exceeded \$1.5 billion, or 3 per cent of general government revenue.

24. The government guarantees provided to State owned enterprises have varied by specific GBEs and governments. However, despite the diversity, there is a clear trend for governments to seek to end or limit these guarantees. Adoption of a Corporations Law entity is one method of achieving this. Where these can not be limited or remain implicit and the contingent liabilities are large, governments have sought where possible to exit. This is particularly obvious and explicit in the Western Australian Government thinking leading to the sale of BankWest and the Victorian government’s thinking on the sale of the final part of Loy Yang B power station.

Drivers for Reform

25. The two main drivers of GBE reform in Australia were the need for money (particularly at the State level) and the recognition that Australia’s productivity performance and competitiveness were being dragged down by poor GBE performance. Specific factors driving the reform of Australian GBEs include:

- **generational change** in the early 1980s which led to external expertise and different professional backgrounds being introduced into the statutory authorities;

- the **structural imbalance in the Federal budget** from the 1970s and the response of successive Federal Treasurers to cut grants to the States and reduce net payments to the Federal GBEs in order to maintain spending on health and welfare (Figure 1.4);
- the **consequent pressure on State budgets** from the reduced revenue grants and the poor tax base available to the States which then in turn led the States to reduce net payments to their GBEs (Figure 1.5) and impose higher charges for their services (Figure 1.6);
- parallel and **concurrent reform initiatives** within the budget sectors;
- the **excessive investment in electricity** capacity in NSW and Victoria in the late 1970s-early 1980s¹⁰ and **the inability to control investment costs**, particularly in Victoria's Latrobe Valley, forced recognition in both business and government, that GBEs were too big an issue to be left unwatched¹¹;
- "**competitive federalism**," which consisted of competition between States for new investment. For instance, in Western Australia the catalyst for the Minister to proceed finally to reform the then monolithic State Energy Corporation (SECWA) was the loss of processing of Western Australian mineral sands to Gladstone, Queensland, due to cheaper electricity prices;
- recognition by the Federal government and industry associations, such as the Business Council of Australia, that the mandate for ongoing tariff reduction depended on broad **endorsement of micro economic reform**, including reduced, or at least reasonable, charges to business and exporters for energy, transport and communications;
- continual **loss-making activities** such as the major NSW irrigation schemes;
- **the failure of the State banks** and other financial institutions in Victoria and South Australia which resulted in sudden and substantial increases in State debt;
- **deregulation of the banking sector** which opened competition, concurrently allowing foreign bank entry and reducing the rationale for government and State-based banks. In this environment, both the Western Australian and Queensland governments in the 1990s chose the exit strategy of reforming their financial institutions to ensure that the banking skills and employment remained based in their respective States;
- the need for **major debt reduction** in the case of Victoria, South Australia and Tasmania and Victoria's desire to **restore former AAA credit ratings**;
- fundamental **reconsideration of the boundaries** between public and private sector activity prompted both by an increasing number of reviews demonstrating investment "gold plating" and labour "feather bedding" on a broad systemic basis and a fundamental reassessment of the principles and issues involved; and
- recognition that asset sales can be used to **finance new initiatives**. For instance, the proceeds of the Commonwealth's one-third sale of Telstra will be used to establish a National Heritage Fund to fund *inter alia* natural resource projects and a wide variety of regional schemes.

Similarly, the Labour government in NSW has proposed that the \$22 billion privatisation of the State's electricity industry be used to repay fully State debt, with the balance to be used primarily to upgrade the State's water supplies.¹²

26. These driving forces have developed over the last decade and a half and have applied differently to the Commonwealth and the individual States.

Different Pressures & Responses

27. The Australian experience with GBE reform is not homogeneous. Australia is a federation comprising six States, two territories and a federal government. All own and control GBEs. The extent of reform and privatisation in their GBEs reflects the varying pressures to do so — particularly the underlying budgetary and debt positions. For instance, in the decade to 1992, Victoria trebled its debt as a percentage of Gross State Product, was downgraded from AAA to AA minus by Standard and Poors, had several major financial institutions fail, suffered a longer and deeper recession in the early 1990s than any other State and resulted in the State having to borrow to fund recurrent budget expenditures. It is, therefore, no accident that Victoria is now the undisputed leader in GBE reform. Its reforms have included the:

- restructuring of markets and entities to maximise competitive outcomes in the core utility industries, including those traditionally perceived as natural monopoly industries;
- pushing the magnitude and extent of privatisation further than all other governments. Victoria averaged 18 per cent of Australia's total GBE capital stock as at June 1990 but represents 35 per cent of net asset sales privatised in this decade to June 1997.

28. In general, those States which have been under most financial pressure, have done much more to reform their GBEs than have States with a strong growth and resource bases and a sound financial position, such as Queensland and Western Australia.

29. This diversity in reform effort and intent will be narrowed by the stringent timetable for implementation of National Competition Policy (see Part 4 below).

Reform Strategies

30. Australia's GBEs have been subject to accumulating and concurrent reform processes and strategies. In broad terms, these are: Some early landmarks in thinking on GBE reform include:

- the appointment in 1982 of Dr John Paterson, a leading public sector reformer, as CEO of Hunter Water Board;
- the several reports of the Senate Select Committee on finance and government operations chaired by Senator Peter Rae, culminating in the 1983 report, Statutory Authorities of the Commonwealth;
- the 1982 report of the Victorian Public Bodies Review Committee;

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- the Hawke Government's action in 1987 to establish the Structural Adjustment Committee (SAC) of Federal Cabinet. The SAC included all major economic ministers and effectively replaced the Expenditure Review Committee as the key Cabinet committee; and
- the commissioning in 1988 of a comprehensive review of the provision by governments in Australia of marketable goods and services. The resulting report by the Industries Assistant Commission provided the benchmark assessment of the impact of government charges (other than taxation) on the international competitiveness of Australian industries, outlined reforms to date and the direction of emerging best practice in each area of GBE activity.¹³

31. In broad terms, five major steps in Australian reform strategies can be identified. These are:

- **commercialisation** has been ongoing and widespread leading more recently to extensive contracting out and application of the purchaser/provider principle;
- **corporatisation** as a formal process from 1988 onwards, beginning with the Sturgess Committee report which established a clear blueprint for New South Wales, and a yardstick for all other governments;
- **privatisation**. In the late 1980s there was considerable restructuring by the Commonwealth of property, land, other assets and defence facilities. The Commonwealth sold the Williamstown Naval Dockyard in Victoria and the aircraft workshop in South Australia; it converted the former Government Aircraft Factories at Fishermen's Bend and Avalon into a Government owned enterprise, Aerospace Technologies of Australia, to be run on business lines.

32. In the States, privatisation began on a spasmodic case by case basis with the Government banks, insurance offices and other GBEs operating in essentially commercial markets. Since 1992, the Victorian Government has led the way in privatisation with the systematic and thorough restructuring of market arrangements to promote competition and highly successful trade sales of major assets, particularly in the electricity industry; and

- **national competition policy**. This agreement by all Australian governments formalised and extended thinking on GBEs and national competition which had been developing for almost a decade, but particularly, since 1990 and the establishment of the SPC process. At the 1995 meetings of COAG, all governments agreed, *inter alia*, to:

- extend the application of the Trade Practice Act to GBEs;
- ensure competitive neutrality between public and private owned entities, pricing oversight of monopoly services and access to essential facilities;

This fundamentally radical policy will affect all areas of government business activity, and provides new imperatives for corporatisation and commercialisation;

- ensure to implement previously agreed reform strategies in electricity, gas, water and transport.

33. The National Competition Policy (NCP) agreements apply to all levels of government, including local government. They require a systematic and pro-competitive review of all Commonwealth and State

legislation with the intent of removing barriers to competition and the establishment of access regimes for essential infrastructure, whether publicly or privately owned.

34. Because the bulk of the reforms must be undertaken by State and local governments, these governments will receive substantial “*competition dividends*” from the Commonwealth for complying with the implementation schedule. National Competition Policy therefore unifies approaches and accelerates the timing of GBE reform in Australia.

Reform Philosophy

35. The Australian approach to GBE reform has recognised, since at least the 1988 corporatisation blueprint, that reform of market structures and the introduction of competition is essential to the achievement of efficiency in service delivery. While there has been, and remains, considerable emphasis on ownership and governance arrangements, there is a general recognition that the competitive environment and consequent incentive structures are the key drivers of efficiency in any entity -- regardless of sector and ownership.

36. As a consequence, corporatisation in Australia was defined at the outset as involving market reforms and Australian governments have generally been at pains to prevent a repeat of the British experience where major privatisations, such as British Gas, occurred prior to separation of functions and activities and market restructuring.

37. Australia has been assisted in GBE reform by its proximity to New Zealand and distance from the United Kingdom. The increasingly severe economic and financial pressures on successive New Zealand governments ultimately meant that the Labour government of Roger Douglas embarked on a radical ‘ground-up’ restructuring and reform of markets; institutional arrangements and GBEs. As a result, New Zealand has become a close and readily observable example and test bed for Australian thinking on GBE reform. The flow of ideas has been two-way with economists from the Monash and Australian National Universities playing significant roles.

“Australian companies financed our research ideas development but it was the New Zealanders who applied it.”¹⁴

38. The New Zealand GBE reforms offset the frequently negative impression of the Thatcher reforms and reminded Australian observers that GBE reform is best undertaken for a clear economic purpose.

39. The emphasis of the New Zealand and Australian reforms has been to get market structures right and to ensure productivity and efficiency. Privatisation is seen as a means to this end and not an end in itself.

40. The pursuit of privatisation for political objectives, for the sale proceeds or to inculcate a nation of investors have not been significant drivers of GBE reform and privatisation in Australia or New Zealand.

“Certainly at the Commonwealth level we were very keen to avoid the UK experience which seemed to us to be privatising for the money, not the productivity gain.”¹⁵

Corporatisation

Background

41. Major GBEs had traditionally been operated as statutory authorities or Corporations under their own specific legislation.

42. A systematic, rigorous and public approach to corporatisation in Australia began in 1988 following the election of the Greiner Government in New South Wales. The immediate Commission of Audit and other reviews identified serious weaknesses in the management and efficiency of the State's GBEs. The issues were addressed by the (Sturgess)¹⁶ Steering Committee on Government Trading Enterprises. By September 1988, "A Policy Framework for Improving the Performance of Government Trading Enterprises" had been delivered by the Committee with the assistance of external consultants, including, importantly, two New Zealand economists.¹⁷

43. The Sturgess Committee not only provided the blueprint for the subsequent NSW corporatisations but:

- publicly set the direction and benchmark for the management and governance of government owned enterprises in Australia;
- countered the earlier and more interventionist view of Victoria's Cain Government;¹⁸ and
- set the direction of NSW (and the subsequent Australian wide National Competition Policy) reforms to ensure that GBEs operate in a competitive environment that does not advantage them over private sector entities.

44. Specifically, the NSW framework recognised all major elements of competitive neutrality including the need for an equivalent tax regime, fees for debt guarantees provided by the Treasury and application of restrictive trade practice legislation.

Essential Principles of Corporatisation

45. The NSW framework for corporatisation recognised that a GBE's performance is a function of the incentives it faces. The framework identified five conditions that must apply to ensure that GBEs use resources efficiently. These are:

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- Clarity of Objectives – The unbundling of social, regulatory and commercial objectives of each GBE to focus management on the bottom line.
- Managerial authority – An organisation’s key internal decisions should be made by individuals with strong incentives to maximise the value of the organisation and who possess the requisite specific knowledge. Externally-imposed controls stifle managerial innovation and dilute and diffuse responsibility between management and the government agencies that impose the controls.
- Performance monitoring – Unless GTE performance is subject to rigorous independent monitoring and assessment, other reforms are unlikely to generate significant efficiency gains. The assessment of comparative performance requires specialist expertise.
- Rewards & Sanctions – A vigorously applied system of managerial rewards and sanctions is an essential requirement for sound performance. Reluctance by Ministers to reward good performance or apply sanctions in the event of non-performance will greatly undermine the effectiveness of performance-based reward systems.
- Competitive Neutrality – To ensure that goods and services are supplied by the most efficient competitor, it is necessary to remove the special advantages and disadvantages that apply to GTEs by virtue of their ownership. If goods and services are not supplied by the most efficient enterprises, society will pay more than is necessary and valuable community resources will be wasted. Special advantages and disadvantages also undermine the reliability of standard commercial criteria as the basis for assessing GTE performance.¹⁹

46. The Sturgess Committee also recognised that in situations where the market power of GTEs is likely to impair efficiency, government-imposed controls on pricing and industry structure will be necessary.

47. “These should take the form of explicit regulations based on careful analyses of the economic and technical issues concerned.since this is necessary to prevent the abuse of monopoly power while maintaining the accountability of GTE managers in terms of clearly specified commercial criteria.”²⁰

The NSW Corporatisation Framework

Incentives and Governance

48. On the basis of the features of publicly-listed companies and the differences between public and private ownership, the Sturgess Committee recommended broad organisational structure and incentive arrangements for corporatising GBEs. These were:

- all significant business units within the public sector that are principally involved in the delivery of services which are, or could be, traded in the market place without compromising

the government's social or economic objectives should be established as commercial entities with ownership vested in the responsible Minister(s);

- any regulatory and policy advisory activities which are presently undertaken by organisations which contain GBEs should be undertaken by separate bodies;
- boards of directors should be established for each GBE with board appointments being made by the shareholding Minister(s) in conjunction with the Premier and Treasurer on the basis of commercial expertise;
- subject to any special regulatory conditions, boards of directors should be given the objective of maximising the return on the GBE's assets. Ministers should reward and apply sanctions to directors on the basis of performance achieved;
- boards should be given full discretion to hire and fire senior executives and to set their remuneration on the basis of standard commercial practice with the assistance of consultants expert in such matters;
- formal contact between shareholding Ministers and boards of directors should be kept to the minimum level required to preserve management autonomy and accountability;
- wherever possible, the subsidised functions performed by GBEs should be awarded on the basis of a tender process, with GBEs competing on a commercial basis with alternative providers of the activity or service concerned. The subsidised services provided should be based on a formal contract, involving explicit compensation, between government and the GBE concerned. Cross subsidies within GBEs should be avoided, except where they can be justified on commercial grounds;
- boards should negotiate an annual "*Statement of Commercial Intent*" with shareholding Ministers covering the broad scope of each GBE's activities, targets against which commercial performance will be assessed, major financial ratios, and dividend policy;
- clearly-defined and well understood information reporting requirements based on private sector practice for wholly-owned subsidiaries should apply to GBEs. Sanctions should be applied in the event of unsatisfactory information disclosure; and
- specialist private sector analysts should assist officials in monitoring and assessing GBE's commercial performance. Monitoring should involve evaluating information provided through official reporting channels and continuous analysis of other information relevant to the assessment of comparative performance.

Recognition of Competitive Neutrality

49. The Committee recognised that the corporate form and substance will not necessarily improve overall efficiency unless GBEs face efficient price signals in their input and output markets. Successful corporatisation was therefore seen to require:

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- a) the exemption of the senior executives of GBEs from the Statutory and Other Officers Remuneration Tribunal and changes to bring the labour market arrangements of GBEs into line with private sector practice.
- b) The termination of all captive government business received by GBEs. Normal commercial criteria should apply in government's selection of suppliers and service providers including, where appropriate, the social activities it wishes to supply through commercial organisations.
- c) The introduction of an explicit fee for GBEs for the government guarantee of GBE debt. The proceeds of such a fee would accrue to the consolidated fund. The fee should be set on case-by-case using a specialist agency to assess the credit rating of each GTE on the assumption that there is no government guarantee of GBE debt.
- d) The adoption of arrangements which enable GBEs to raise the equity capital required to finance investment opportunities which are expected to at least achieve the relevant market rate of return.
- e) A thorough analysis of the optimal regulatory environment for each GBE with a potentially harmful degree of market power (e.g. natural monopolies such as the Water Board). Following a comprehensive study of each industry concerned, an explicit regulatory regime (e.g. for prices charged) should be established for each industry, with GBEs being given the objective of maximising returns within the restrictions imposed by the regulatory environment.
- f) The making of representations to the Loan Council to exempt GBEs which have been fully corporatised from the global borrowing limits.
- g) The application of a neutral tax environment for GBEs.

50. To implement the recommended framework, the NSW Government enacted the State Owned Corporations (SOC) Act (1989) to provide a single legislated model for corporatisations, established the Government Pricing Tribunal to regulate the prices of the natural monopolies and formed a centralised GTE Reform Unit within the Premier's Department to direct and facilitate the reform process.

Outcomes

51. In NSW itself, the Greiner Government actually corporatised only five GBEs -- three immediately prior to privatisation. However, the corporatisation framework provided a process for review and reform with consequences well beyond a formal change in legal status and governance arrangements.

52. The Greiner Government's stocktake of the six years of GBE reform to 1994 was able to report impressive results:

- labour productivity in the State's major electricity, water and transport utilities had risen 78 per cent;
- net debt had fallen 27 per cent between 1990 and 1994;

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- dividends had increased by one billion dollars (or by almost 5 per cent of the 1993-94 State revenue of \$22.4 billion annually); and
- real prices had fallen slightly.

53. Following the NSW SOC Act, most States re-examined the same issues with Victoria and Queensland subsequently adopting similar uniform legislation and a centralised reform unit located in one of the central agencies.

54. Other States, such as Western Australia, did not, preferring to retain tailored legal structures under entity specific legislation and to drive reform from the GBEs rather than from central agencies such as the Treasury.

55. Corporatisation has continued to be a strong feature of GBE reform in NSW. The new Carr Labor Government announced in June 1995:

- amendments to the SOC Act to provide a new legal entity, the Statutory State Owned Corporation, to enhance parliamentary accountability by separating and clarifying the respective roles of the Portfolio Minister, the shareholding Ministers and the board of directors, and by using a non-company structure; and
- a comprehensive program of corporatisation of a further 13 GBEs. By mid-1997 the major components of this program, including the reform of the electricity industry, had been accomplished.

Commonwealth Approaches to Corporatisation

56. At the Commonwealth level, the major GBEs, including Australia Post, Telecom, Qantas and Australian Airlines (formerly TAA) already operated under their own Acts as separate legal entities. However, many of the smaller business activities were still intertwined with departmental responsibilities until 1987.

57. The central principle of the 1987 commercial reforms was the separation of Ministerial and departmental responsibilities.²¹ These reforms included:

- the Commonwealth removing over 40 long standing controls from its GBEs. These included their right to enter into contracts without ministerial approval, exemption from processes under the Public Works Committee Act in 1969, their ability to invest surplus monies and enter loan contracts without Government approval, the right of the board to dismiss the Chief Executive, the removal of many public service staffing and administrative practices, and their right to establish their own superannuation schemes; and
- the Commonwealth setting up a mechanism for setting clear GBE objectives including strategic directions, financial targets and distribution policies. It also improved reporting requirements to both relevant ministers and the Parliament.

58. In the May 1988 reform package the Commonwealth made many changes to the competitive environment for telecommunications. The key change was to establish AUSTEL which took over

Telecom's regulatory functions. This was the first stage on the path that has led to the current reforms. In the late 1980s the Civil Aviation Authority was corporatised and all federally controlled airports were corporatised under the Federal Airports Corporation.

59. In 1989 various changes were made to Australia Post, involving corporatisation and making Australia Post liable for the same taxes and charges as its competitors.

60. The 1993 Guidelines further clarified accountability and oversight requiring:

- ministers to set a clear mandate for each GBE, to influence strategic directions proposed by Boards having regard to shareholder risk, agree financial targets and dividend policy and approve borrowing limits subject to Loan Council processes;
- skills-based boards accountable for performance; and
- boards to report regularly to Ministers on strategic plans for meeting objectives and on performance against objectives, and allowing direct requests for financial information from the GBEs by the Minister for Finance.

61. Implementation of the Humphrey (1997) review of GBE Governance Arrangements will mean that the dwindling number of Commonwealth GBEs (Figure 2.3) will also operate under Corporations Law and that the responsibilities of shareholders will become jointly shared between the portfolio minister and the Minister for Finance.

3. Privatisation

62. Privatisation and asset sales of GBEs in Australia have:

- been dominated by the States and the State of Victoria in particular (Figure 3.1);
- been predominantly a feature of the 1990s with little activity prior to 1991 (Figure 3.2). Net asset sales (net advances) by the Commonwealth (consolidated) in the five years ending 1995-96 were more than 6 times the sales level in the previous five years. Similarly, net asset sales by State and territory governments (consolidated) were of similar magnitude to the Commonwealth in the latter period and were negative in the earlier period;
- realised more than \$16 billion in net advances for asset sales in the five years to June 1996;
- been dominated by trade sales. While slightly more than half of the Commonwealth's privatisations have been share floats, trade sales account for more than 80 per cent of the Victorian privatisations. Management buyouts have been of negligible importance in the total picture;
- generated sales prices well in excess of initial expectations;
- typically been preceded by restructuring of the GBE and its market place. Of particular relevance to the GBEs in the traditional utility segments, Australian governments agreed in

the early 1990s to establish a national electricity market, a national gas market and to establish clear property rights to water and to promote trade in these entitlements; and

- been the source of significant friction between the States and the Commonwealth over tax issues.

Figure 3.1. Net Asset Sales - Net Advances Paid, 1986-87 to 1995-96

(\$ billion)

	TRADING ENTERPRISES	GENERAL GOVERNMENT	CONSOLIDATED GOVERNMENT
Commonwealth	-0.2	22.7	20.0
State and Local	12.7	10.6	16.4
Victoria	12.7	7.0	15.4

Source: *Government Financial Statistics, Australia (ABS Cat. No. 5501.0)*

Sales Process and Methods

63. Australian governments have employed, and continue to employ, all sales methods, including share floats, trade sales and management buyouts. Nonetheless, there is a clear pattern and trend.

- The privatisations of household name GBEs operating in competitive markets with clean reputations and balance sheets have involved share issues to the general public. This limited group includes the Commonwealth Bank, TABCORP in Victoria and the forthcoming Telstra float.

All share offerings traded at premiums immediately after listing and most offerings have reserved shares for employees. For example, the current Telstra float calls for 3-8 per cent of shares to be taken up by employees. However, one exception to this trend was the 1992 float of the Government Insurance Office (GIO) which did not reserve shares.

Since the intent of Australian governments in the privatisations has been to withdraw from that area of activity and to put in place major market restructuring and explicit regulatory reforms where required, governments have not sought to retain golden shares.

- Dual sales approaches have been employed in cases where the selling government has multiple objectives. For instance, the Queensland and Western Australian governments recognised that a straight float would lead to the ultimate absorption of their State banks into the networks of the major banks. Both therefore combined trade sales with public share floats to maximise returns within the context of securing local investor participation, ending ongoing liabilities and securing ongoing location and domicile of major banking operations in their State. Similarly, the Commonwealth Government sold 25 per cent of the national airline, Qantas, to British Airways to secure a strategic alliance, before floating the remaining equity to institutions and the general public.
- Trade sales for new entities operating in restructured natural monopoly industries of electricity and gas and for the majority of other privatisations.

- Management buyouts were few, the most typical being technical areas such as laboratories and specialist engineering.

64. In contrast to conventional finance theory which suggests that sales prices will be highest when shares are sold most broadly, Australian governments have demonstrated a clear preference for trade sales rather than share floats to privatise the vast bulk of GBE assets. Factors leading to this preference for trade sales include:

- the greater ability of trade purchasers to assess the value and risk of specialty non household name businesses, particularly where the balance sheets contain some doubtful assets or where the regulatory and market environments are new and, therefore, uncertain;
- the arduous information disclosure and due diligence requirements imposed under Corporations Law on share prospectuses and earnings forecasts and, as a result, the higher cost and slower speed of share floats compared to trade sales; and
- the ability to generate very substantial premiums above the sales prices that would be obtainable via a share float. The Commonwealth sale of the major airports and the Victorian electricity privatisations demonstrate this phenomenon very clearly.

Sales Proceeds

65. Sales proceeds from GBE privatisation and asset sales in Australia have, to date, been dominated by the activities of the Commonwealth and Victoria.

- between July 1990 and June 1997 gross proceeds for the Commonwealth exceeded \$13.8 billion (Figure 3.3); and
- the Victorian Government's gross proceeds for electricity assets sold to June 1997 total \$17.8 billion and a further \$1.2 billion for other sales (Figures 3.4 and 3.5).

66. A more comprehensive perspective — and one more relevant to the budgetary impact of the sales is provided by the Australian Bureau of Statistics measure of “net advances paid” in the net asset sales category. This item covers major equity sales or major capital injections and redemptions of State debt to the commonwealth.

Sale Premiums in Victorian Electricity Privatisations

67. The Victorian electricity industry was substantially restructured in 1993/94 to maximise competition and contestability (Figure 3.5). The Victorian electricity industry has been transformed from a minimal risk, statutory monopoly to a highly competitive, highly geared industry with an aggressive spot market. Risk is now commercial and real.²²

68. Nonetheless, the sales prices achieved have consistently exceeded initial expectations and valuations. Electricity asset sales proceeds to mid-1997 exceeded \$17.8 billion with several utilities still

to be sold. The final aggregate expected figure of up to \$22 billion compares with early market expectations in 1994 of less than half this estimate.

69. These sale premiums have been achieved for assets in a competitively restructured industry. The premiums have not been the result of selling entities with monopoly power. Rather than avoiding market restructuring in order to maximise sales prices or undertaking radical reform and jeopardizing sale prices, Victoria appears to have achieved both objectives simultaneously.

70. Factors leading to very strong sales prices for Victorian electricity assets include:

- the **low cost** of Victorian electricity compared with NSW generated power in the context of agreement that there will be a national electricity market;
- the ability to establish an **immediate presence** in the emerging east coast market for electricity -- when interstate competitors are still public owned utilities with still powerful unions -- a belief amongst purchasers that greater economy and efficiency could be obtained, and the probable underestimation of the impact of emerging competition on the spot price for electricity;
- **the low sovereign** risk of Australia in general and Victoria in particular, compared with alternative utility investment opportunities in Latin America or South East Asia. In terms of political stability, the reforming Kennett Government had been returned with an even more overwhelming majority. Further, its policies are consistent with — albeit well ahead of — the national framework for competition reform and electricity in particular;
- **US regulatory developments**, particularly the 1996 decision of the Californian Public Utilities Commission, promoted greater competition in electricity by encouraging the divestment of integrated electricity by encouraging the divestment of integrated electricity assets leaving US utilities with considerable capacity to invest;
- the use of **asset rather than entity sales** which allowed higher levels of depreciation to be claimed for tax purposes by the purchaser. When combined with **highly geared** financial structures meant that little or no company tax was payable for a decade or more after the sale; and
- the use of **trade sales** to foreign investors rather than share floats to domestic residents who, under Australia's tax dividend imputation system, seek fully franked dividend streams.

71. Among these several factors leading to the sale premiums for Victorian electricity assets, the tax shields created by higher depreciation and high gearing are estimated to account for up to one third of the total sale prices.²³ The same tax shields and mechanisms have led to similar premiums in the Commonwealth's sale of Melbourne, Brisbane and Perth airports.²⁴

Privatisation and Tax in a Federal System

72. The ceding of the income tax powers of the States to the Commonwealth in 1942 has had important effects on GBE reform in the 1980s and 1990s.

Reforming Public Enterprises: Australia

- In essence, the Commonwealth Government has the broad taxing powers and the States have the responsibility for service provision, including GBEs. The imbalance between the States and the Commonwealth in the revenue powers and spending responsibilities has been a major driver of GBE reform in the States. Equally, it ensures strong tensions with the Commonwealth in the privatisation process.
- Most Australian GBEs are owned and managed by State governments and are not taxable by the Commonwealth. Traditionally, taxation by the owner government was informal via dividend flows. As a result, the taxation of business enterprises in Australia differed substantially between public and private enterprises until tax equivalent regimes began to be introduced particularly from the early 1990s. Arguments for competitive neutrality, in particular, consistent tax treatment between public and privately owned business entities, were warmly received and supported by State treasuries and finance departments since the principle of competitive neutrality combined reform with an additional source of revenue.
- Because the dividends paid by GBEs to the State treasuries included a significant component of what would otherwise have been income tax, privatisations of State GBEs not only mean that dividends were paid to the new shareholders, but that the (implicit) income tax payments were transferred to the Commonwealth. This transfer of income tax revenue to the Commonwealth emerged as a major block to privatisation by the States. Consequently, Victoria and South Australia sought and received tax compensation payments from the Commonwealth totalling \$600 million in respect of the trade sales of their failed State banks.²⁵

73. Arrangements for tax compensation were formalised -- and restricted -- at the March 1994 Premiers' Conference when the Commonwealth, State and Territory Governments agreed that:

*"The Commonwealth ... will provide [tax] compensation, in relation to income tax.... for no more than one bank or insurance office in the State or Territory where the privatisation of the bank or insurance offices commences before 1 July 1995; ...[and] will consider compensation, on a case by case basis, ... where a STE [State Trading Enterprise] is fully privatised."*²⁶

74. The impact of this agreement was an immediate imperative for privatising the remaining State banks and, in effect, to end the Commonwealth's payments for further compensation. Aside from the bank and insurance office privatisations, no further tax compensation has been paid by the Commonwealth since 1994.

- While privatisation means the State treasuries may lose to the Commonwealth the flow of implicit income tax from the GBE, any reduction in the size of the windfall to the Commonwealth of future tax payments by the privatised entity is potentially capturable by the State in the form of a higher sale price.

75. By adopting highly geared financial structures, prospective purchasers could reduce or avoid paying tax for a decade or more -- and therefore be able to trade this off for a higher price. Since the trade sales of GBEs are competitive processes, the potential for a higher sale price is fully captured in the actual sales price.

76. The ability of highly geared structures to reduce income tax derived primarily from the interaction of the normal deductibility of interest payments and standard tax law applicable to the purchase of any entity which allows depreciation for tax purposes to be based on the purchase price of the entity.

77. Following the decision by the NSW Government that it would also sell its electricity businesses for an estimated \$22 billion,²⁷ the Federal Treasurer in July 1997 moved to protect the Commonwealth's windfall, announcing changes to income tax law on the valuation of assets for depreciation for tax purposes.²⁸ Specifically, two different rules will apply:

- purchasers of assets or businesses previously paying tax, i.e. privately owned assets and businesses, will still be able to deduct depreciation based on the purchase price;
- purchasers of previously tax exempt assets and businesses, i.e. from State government owned enterprises, will only be able to deduct depreciation based on valuations shown in the audited accounts prior to 1 July 1997.

78. The tension caused by Australian tax arrangements is an ongoing impediment to the privatisation of the bulk of Australian GBEs since these are held by the States. However, the Commonwealth alone controls tax law.

Transitional Staffing Arrangements

79. There has been little uniformity (Figure 3.6) in the way Australia's public sector employees have fared in the process of privatisation.

80. Under Australia's Industrial Relations Act, in the case of transmission of government owned businesses, award entitlements must be carried over to the new privately owned organisations. Other benefits, however, are not guaranteed. Thus, the transfer of personnel and benefits, such as superannuation entitlements, has varied markedly. For example, some employees, such as those at the Port of Portland have been offered continued employment within the privatised organisations; some have also been able to transfer their superannuation entitlements. Others have been offered the alternative of substantial voluntary redundancy packages. Employees of some government enterprises, however, have had no choice but to accept compulsory redundancy with less attractive packages.

81. Unions have generally acted as the main bargaining agents for the government corporation's employees. In some cases, such as Victoria's Electricity Corporation, public sector unions have been allowed to continue to represent their members after privatisation. In other cases employees continuing with the privatised organisation have had to join a new private sector union.

82. In most cases privatisation has been associated with a reduction in permanent full-time employees. This is, however, not an exclusive association; many government enterprises were in the process of downsizing prior to privatisation. In the case of the State Electricity Commission of Victoria, for example, at the time it was privatised in 1992, staff numbers had already been falling steadily from 22 000 in 1989 to 14 500. As a result of privatisation the number of staff involved in electricity generation, distribution and retail has fallen further to 7 000.

83. While full-time employee numbers have fallen with privatisation, there has, at the same time, been a steady increase in outsourcing and the employment of staff on contract. This move to contract

labour is also a move to non-unionised labour and it thus provides a continual competitive yardstick that endangers the leverage power of unions. For this reason, the successful efforts of some public sector unions to be allowed to follow their members to the private sector may prove hollow victories. The relative importance of employees in the workforce can be gauged from either their numbers or the wage shares in the sector. The proportion of wages, salaries and supplements paid by public enterprises has fallen markedly in the last 20 years, and particularly in the last five (Figure 3.7).

4. National Competition Policy

84. The adoption of National Competition Policy²⁹ (NCP) by Australian Governments in 1995 is a radical, far reaching decision with major pro-competitive impacts on all government business activities and on private businesses' use of essential infrastructure.

The Agreements

85. The NCP commits all Australian governments to give effect to three agreements:

- the **Conduct Code** — which extends Australia's legislation on restrictive trade practices to government business activities. Specifically, the Code extends the application of Part IV of the Trade Practice Act to all persons within their jurisdiction in order to ensure universal and uniform competitive conduct rules for all market participants, regardless of ownership or legal form. A GBE is, therefore, now subject to the same legislative constraints on anti competitive behaviour as any private corporation;
- the **Competition Principles Agreement** which commits governments to a range of actions to promote competition; and
- the **Agreement to Implement NCP and Related Reforms**. This Agreement covers *inter alia* the electricity, gas and water policy reforms previously explored and endorsed by COAG.

86. Importantly, the Agreement to Implement also sets down the compliance conditions and schedule of payments to the States to ensure that the benefits of the reforms are shared.

87. For example, payments to each State under the second tranche of the Competition Payments will be conditional upon:

- 1) that State continuing to give effect to the Competition Policy Intergovernmental Agreements, including meeting all deadlines;
- 2) effective implementation of all COAG agreements on:
 - the establishment of a competitive national electricity market;
 - the national framework for free and fair trade in gas; and
 - the strategic framework for the efficient and sustainable reform of the Australian water industry; and

3) effective observance of road transport reforms.

88. While all elements of NCP are intended to affect and determine the direction of GBE reform, the Competition Principles Agreement is especially relevant.

The Competition Principles Agreement

89. This accord commits Australian governments to:

- **prices oversight**, i.e. to consider the establishment of independent sources of prices oversight advice with respect to government business enterprises where these do not already exist;
- **competitive neutrality**, i.e. to remove any net competitive advantage enjoyed by significant government enterprises by virtue of their public sector ownership, subject to the benefits outweighing the costs.³⁰

This requires that significant business activities (Type 1) be subject to the full suite of competitive neutrality policies, i.e.

- corporatisation,
- full Commonwealth and State status or tax equivalent systems,
- debt guarantee fees,
- relevant regulations to which the private sector is normally subject (such as those relating to protection of the environment and planning and approval processes).

Where a government agency undertakes significant business activities as part of a broader range of functions (Type 2), governments are required to:

- where appropriate implement a tax equivalent system, debt guarantee fees and equivalent regulation, or
 - ensure that the prices charged for goods and services take account of these items **and** reflect full cost attribution.
- **structural reform of public monopolies**, including separation of regulation from other functions, i.e. when introducing competition to a sector traditionally supplied by a public monopoly, remove from the public monopoly any responsibility for industry regulation, and undertake a review of the appropriate structure and regulatory framework to be applied to the industry;
 - **legislative reviews**, i.e. to review and, where appropriate, reform all existing legislation that restricts competition, by the year 2 000 and thereafter every ten years in line with the guiding principle that legislation should not restrict competition unless it can be demonstrated that:
 - the benefits of the restriction to the community as a whole outweigh the costs, and
 - the objectives of the legislation can only be achieved by restricting competition; and

- **access principles**, i.e. conform to a set of agreed guiding principles to facilitate third party access to services provided by significant infrastructure facilities to which access is necessary to permit effective competition in an upstream or downstream market.

Implications for GBE Reform

90. NCP is radical not because any one element is new — indeed virtually every element can be found in existing government policies on competition or GBEs. Rather, it is radical because two fundamental principles:

- the power of competitive markets and
- the need for competitive neutrality between government owned and private businesses

are applied universally to all business activities undertaken by all levels of government. Importantly, the agreements also cover local government, which has significant business activities in most States, but particularly in Queensland and, to a lesser extent, in New South Wales.

91. National Competition Policy could be described as “mega corporatisation” if corporatisation is seen broadly, that is, as entailing fundamental reviews of market structure and all other elements, as it is in the NSW 1988 framework. To do so, however, would be to understate the breadth and implications of the policy. Importantly, it covers large areas of private sector activity on a common and uniform basis with government business activities whether or not they are GBEs. Access to essential facilities refers to more than access to essential government owned facilities. Similarly, the legislation reviews cover all legislation ranging from the GBE legislation to the legislation underpinning the legal and other professions. As noted, it also covers local government which has previously been largely omitted from the reform processes and ensures that all governments comply within an agreed timetable. The speed and uniformity of reform — though not the quality — are therefore guaranteed.

92. NCP has major implications for the direction and pace of GBE reform in Australia.

93. First, it strongly reaffirms the commitment to market oriented policies. Second, it reduces the discretion to slow or avoid reform by making the competition payments dependent upon meeting the compliance schedules. Third, it has resulted in a centralisation of power within the major policy agencies within each government, i.e. the Cabinet Office and Premier’s Department, the Treasury and Finance Department. The shift in the balance of power away from the GBEs and line departments plus the more extensive use of inter-governmental working parties will lead to different and more uniform policy across Australia. Fourth, the combination of the competitive neutrality principles, the monopoly and the access regimes will fundamentally change the understanding of natural monopolies. Fifth, the requirement of competitive neutrality for corporatisation suggests that Australia will have a higher proportion of its government business activities formally corporatised than in any other country. Sixth, while the NCP is silent on the question of ownership and makes recommendations on privatisation, the process will facilitate privatisation. This is so because by definition, the entire policy package is designed to remove the advantages of continued government ownership and to introduce clearer rules for relationships between the Minister and GBEs.

94. The impact of NCP on productivity, particularly in the short term, is likely to be substantial creating the potential for major reductions in the prices of goods and services supplied by GBEs.

However, NCP does not guarantee that the potential for price reductions will be passed on to customers. This is so because the concept of full cost recovery is seen as central to ensuring competitive neutrality and the pricing rules for full cost recovery and it appears for access to essential facilities are increasingly based on a guarantee of return on the value of the assets. In many cases, but by no means uniformly, application of these asset based pricing rules may result in prices substantially above those required to ensure the commercial viability of the entities turning the GBEs into cash cows for owning governments.

95. Not only are significant business activities (undertaken in conjunction with other functions) required to price at full cost recovery, but electricity, gas and water pricing under the separate national agreements has also moved toward full cost recovery based on guaranteed rates of return on either replacement cost or deprival value.³¹

5. Impact of Reforms

96. The accumulating pace and processes of GBE reform in Australia have been matched by increased productivity, generally lower prices, a significant positive impact on government recurrent budgetary positions and on the macro-economy. In addition, the increasing number of privatisations and asset sales has allowed State governments to repay and restructure their debt levels and the Federal Government to reduce deficits.

97. Importantly, these gains have not accrued due to reduced service levels. On the contrary, service levels appear to have risen and comparative efficiency vis-à-vis foreign competitors has increased.

98. The losers in the reform process have been direct employees in the GBEs. GBE employment has fallen since 1989 by at least one third.

99. With the increasing priority given to GBE and micro economic reform generally, data on GBE performance has become increasingly available in the 1990s. An important initiative was the establishment in 1989 of the Steering Committee on National Performance Monitoring of Government Trading Enterprises. As a result, a reasonably accurate perspective can be developed. GBE performance in the preceding period is much less well documented.

Productivity, Prices and Competitiveness

100. Total factor productivity rose in all sectors of GBE activity at an increasingly faster rate over the past decade and a half. Productivity in electricity, gas and water increased by 80 per cent, 55 per cent in transport and 165 per cent in communications (Figure 5.1).

101. Particularly since 1984-85, total factor productivity growth among GBEs has been substantially stronger than in the manufacturing or the non-farm private sector. The strengthening of GBE productivity growth predates the commencement of corporatisation (1988) and the major privatisations of the 1990s.

102. Technological change has played a large and obvious role in productivity growth in communications, but the magnitude of productivity gains in the three utility industries and in transport and storage can be attributed to the poor efficiencies of GBEs historically and to the reform processes of commercialisation, corporatisation and privatisation, increasing role of competition in input and product markets and economies of scale.

103. To a large extent, the GBEs productivity and efficiency were simply improving rapidly from a very poor base level of performance. Nonetheless, the efficiency gains are impressive over a period of a decade and a half. The main mechanism for the observed productivity and efficiency gains was the progressive reduction in over-manning which had typified GBEs in the early 1980s. Comprehensive data on employment in GBEs is not available. EPAC estimates suggests that GBE employment in the late 1970s was around 8 per cent of total employment. For 1988-89 the ABS estimated that for 240 identified GBEs, employment totalled 473 000 or 6 per cent of total employment. Data for major GBEs suggest that employment is now down by one third from the 1988-89 figure with commensurate increases in labour productivity (Figure 5.2).

104. Capital productivity also improved, particularly in the electricity industry as the excess capacity built in the late 70s and early 80s was slowly eroded by demand growth. The return on capital invested in all GBEs rose from around 4 per cent in the early 1980s to more than 7 per cent in the mid 1990s. In contrast, the higher returns to private corporations rose only marginally over the same period (Figure 5.3).

Price Impacts

105. GBE productivity growth had direct impacts on prices charged domestic consumers and business customers. While prices rose between 1989-90 and 1991-92 in the water sector, elsewhere, real prices generally fell (Figure 5.4).

106. Price impacts differed between States reflecting their differential productivity growth. Whereas in 1992 Victoria had the lowest productivity infrastructure across the Australian States, by 1994, the productivity of Victoria's infrastructure had risen to second highest, closely behind Queensland.³² Since high relative productivity implies low prices relative to other States, Victoria by 1994 offered the "*cheapest basket of infrastructure services ... due in large part to its cheap electricity*".³³

Closing Gaps in Competitiveness

107. These price improvements lifted the competitiveness of Australian infrastructure compared with overseas best practice. For instance, in 1975-76, the Australian electricity industry was only 50 per cent as productive as the US investor-owned utilities. By 1989-90, Australian performance had improved significantly to about 71 per cent as productive.³⁴

108. Gains in productive efficiency have been matched with similar gains in allocative efficiency.

Figure 5.5. Allocative Efficiency of Australian Electricity Supply Industry

(Benchmark : US investor owned system = 100)

1975-76	56-73
1990-91	69-90
1993-94	75-92

Source: BIE (1996) *Electricity 1996 : International Benchmarking, Report 96/16, Australian Government Publishing Service; Canberra, November, p106.*

109. The extensive monitoring of comparative performance (Figure 5.6) undertaken by the Bureau of Industry Economics indicates that:

“In respect to price indicators, Australia has moved closer to best practice in the electricity, rail freight, telecommunications and coastal shipping industries.”³⁵

110. Despite the major efficiency improvement in GBEs, other areas of critical infrastructure have barely improved or have reverted.

“The major problem area in terms of reliability remains waterfront container handling. Australian ports are not only among the slowest to move a specified number of containers, but are also among the most variable. In particular, we have a high proportion of delays in excess of 40 hours, which are very costly to ship operators as they usually necessitate missing subsequent ports on the route to maintain overall sailing schedules.”³⁶

111. The contrast between the efficiency improvements achieved in GBEs compared with Australia’s oligopolised ports is indicative of the comparative ease of reform processes when government initially controls all aspects compared with attempting to implement wholesale reforms when the incumbents are private operators.

Budgetary Impact

112. The direct budgetary impact of GBE reforms arises from two main sources:

- the increased efficiency and commercial behaviour of the GBEs which leads to greater productivity, lower per unit costs, higher return on capital invested, lower subsidies, higher dividend and tax payments and lower debt costs. In addition, a more commercial culture and behaviour leads to more effective pricing policies; and
- the proceeds of asset sales which may be used to repay debt or to reduce the headline figure of budget deficits.

113. A detailed analysis of the impact of the privatisation on current account of the budget is provided for selected Victorian electricity asset sales (Figure 5.7). This analysis compares the “no privatisation” scenario with the privatisation outcomes.

114. A less rigorous — but more comprehensive — perspective of the impact of GBE reforms on the current account of the budget can be gained from the direction and trend of subsidies, dividend and tax payments.

115. Dividends and taxes paid were negligible until 1983-84 when Victoria and other governments began to extract significant dividend flows. Dividend and tax payments to the Commonwealth Government jumped sharply from 1990-91 (Figure 5.8). Dividend and tax flows are now approaching 0.7 per cent and 0.6 per cent of GDP for the State and local government and the Commonwealth, respectively.

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116. Subsidies to the GBEs from the budget sector have been held in nominal terms, falling in real terms since the late 1980s. The major subsidies to GBEs are the State governments to the transport sector GBEs (Figure 5.9).

117. Subsidies paid by the Commonwealth to GBEs are a fraction of the subsidies paid by the States. This reflects the larger responsibilities for GBEs historically allocated to the States in Australia and public transport deficits in particular.

118. Expressed as a percentage of GDP, subsidies paid to GBEs by the Commonwealth have been comparatively stable, falling from an average 0.2 per cent in the five years to 1988-89 to around 0.1 per cent currently.

119. At the State and local level, subsidies to GBEs have fallen from a peak of 0.8 per cent in the mid 80s to around 0.4 per cent currently (Figure 5.10).

120. The net flow of transfers and subsidies has been reversed from net payments from net receipts to the budget sector. For the Commonwealth Government, the small net flow swung to positive for the first time in 1989-90 and is now strongly positive (Figure 5.11).

121. For State and local governments, large net subsidies continued to rise during most of the 1980s, peaking at \$2.0 billion in 1986-87. Thereafter, the combination of State subsidy payments and rising dividend and tax payment by the GBEs has led to the falling net subsidies to switch to net receipts for 1993-94.

Budgetary Impact - Capital Account

122. Sales proceeds can be spent upon receipt or used to lower the budgets headline deficit or increase the surplus, and then applied to debt retirement.

123. The immediate impact is the receipt of the proceeds less any directly associated debt repayment.

124. In summary terms, the budgetary impact of privatisations and asset sales has been to increase budget cash flows over the five years to 1995-96 by \$16 billion for all governments.

Service, Quality and Safety

125. Reform of GBEs appears to have been achieved without jeopardising service, quality or safety. In most cases, standards in these areas appear to have been either maintained or improved.

126. In electricity, corporatisation has resulted in greater reliability with less frequent interruptions in supply. The duration of interruptions have also been shorter than during 1994-95 but are still longer than the interruption duration levels achieved in earlier years.

127. In some electricity companies corporatisation has also been associated with technological developments and greater efficiencies; providing not only economic but also environmental benefits. Several electricity companies have been successful in achieving quality assurance certification to ISO

9001 and one, a power producer in NSW, is recognised as being within the top 5 per cent of safe organisations around Australia.

128. In other industries improvements as a result of corporatisation have been less significant. The corporatisation of Australia Post, for example has not led to great improvements in service. It has, however, been able to maintain high levels of service — 99 per cent of articles are still delivered within advertised time or one day later — despite a reduction in the number of post offices and an increase in delivery points.

6. Lessons Learned

129. Australia's GBE reforms have, over the past decade and a half, yielded substantial improvements in efficiency and performance.

130. The Australian experience shows that GBE reform becomes increasingly effective as the reform process widens and is extended more broadly through the economy. A critical feature of the reform process has been the continual emphasis on market and structural reform. Corporatisation has, from the outset, been viewed broadly as much more than merely changing to a corporate legal entity, appointing a board of directors and adopting the trappings of a private corporation.

131. Similarly, privatisation in Australia has either occurred in private markets or after substantial review and restructuring of the natural monopoly and its markets. Australian governments have, generally, been careful not to privatise existing monopolies. The obvious exceptions to this rule include the privatisation of TABCORP which shares a legislative monopoly position in Victoria's gaming industry.

Step by Step

132. A strength of the Australian reform process has been the building on of successive reform strategies (Figure 6.1). The process began with generational change and commercialisation. The second step was the articulation of a formal corporatisation framework including, importantly, the principle of competitive neutrality. This corporatisation framework has continuing relevance.

133. The third step involved the easy rationalisation of defence assets and industries and the necessary private sales of government banks and insurance offices. The first of these bank sales were necessary because the banks had failed and were loaded with debt. The subsequent process was comparatively elementary because:

- there were no major regulatory issues involved with banks and insurance offices which already operated in private markets subject to an existing regulatory and prudential regime;
- the State governments were faced with the inevitability of an increasingly competitive banking sector and a declining value in their investment; and
- the key issue of tax compensation from the Commonwealth had been settled, at least, in respect of bank and insurance office sales.

134. These initial privatisations had the important effect of shifting political attitudes towards privatisation and the acceptance that privatisation should occur where there are net benefits.

135. The fourth step, the creation of new markets and restructuring and privatisation of natural monopolies was necessitated by the poor performance of the electricity industry in the Eastern States and the budgetary situation of Victoria. The disaggregation of the Victorian electricity and gas industries provides test beds for similar market reforms in other States and in other industries. The creation of new markets and competitive opportunities in natural monopoly industries affects not only the incumbent GBE and/or its successors but allows the entry of new competitors — one emerging possibility in the utility industries is the prospect of customers dealing with one, single utility supplying energy and water services.

136. The fifth step is the adoption of National Competition Policy (NCP). This comprehensive endorsement of market oriented policies will further accelerate and unify the pace of reform. Because NCP carefully avoids the issue of public versus private ownership, it commands support from all sides of politics and is likely to be an ongoing force for GBE reform. Although agreed in 1995, the major implementation tasks of NCP at the coal face of the GBEs has only just begun. As a result, the transaction and transitional costs are being incurred but have not yet produced obvious benefits within the GBEs.

137. Nationally agreed co-ordinated frameworks are very powerful forces for good -- or for bad. The political process of establishing a nationally co-ordinated policy and framework does not always accord with the complexities revealed by economic analysis. The challenge in implementing NCP in coming years is to ensure that the pursuit of uniformity and previously agreed goals does not over ride the ability to refine the detail.³⁷

Corporatisation versus Privatisation

138. The traditional debate on whether corporatisation is better than privatisation or vice versa has been recognised as a sterile debate by all Australian governments. Both corporatisation and privatisation are recognised by all sides of politics as essential tools to be applied where best suited.

139. First, there is general recognition that accountability and control issues with GBEs are a special problem:

“Accountability to ultimate owners is considerably less direct for GTEs than private sector organisations. Politicians are the agents for their constituents in the control of GTEs. This increases the risk of political interference (that is, interventions by politicians not in the ultimate interest of the majority of the community) in GTEs’ business affairs and also means that the organisational and monitoring arrangements must provide for Ministers’ accountability to Parliament for the GTEs.”³⁸

140. Second, there is a general recognition that if corporatisation is unsuccessful, then privatisation may need to be considered.

141. The conservative NSW Government stated in 1994 that it did not have a policy of privatising GTEs for the sake of it. Rather, its approach has been that the decision as to whether to privatise a GTE or not should be made after a detailed assessment of the benefits and public interest in adopting such a policy. The following Labor Government in NSW subsequently echoed this view almost precisely.

142. The critical issue is not whether a good, sound corporatisation can deliver the desired outcomes, but whether the incentives for efficiency can be retained in the long run. The Victorian Government's view is that:

*"... combined with an effective regulatory and legislative framework, privatisation typically locks in the benefits of a competitive industry structure and ensures that the industry cannot revert to a comfortable integrated monopoly. Private ownership has a number of additional benefits over public ownership, including the establishment of clearer goals for management, a reduction in the opportunity for non-commercial decision-making, strong capital market discipline, improved performance incentives for staff, and businesses released from State budgetary influences."*³⁹

143. Privatisation has the further benefit of allowing governments to engage in balance sheet management by reducing State debt to regain a AAA credit rating, or to switch to more productive assets.

"...the objective is for a privatisation process that optimises the value to the community of the assets within the parameters Government has set to ensure effective competition. Government is not committed to a fixed timetable. Privatisation will only occur when there is a clear public benefit involved in doing so... ."

144. Both the conservative coalition at the Federal level and the NSW Labor Government have advanced the argument for privatisation on this basis.

145. Though they are distinct economic policies, corporatisation is undoubtedly leading to privatisation. This is occurring for two reasons. First initial corporatisation is often a necessary step on the way to the previously determined objective of privatisation. Second, because once corporatised, thereby introducing commercial boards and removing the advantages of government ownership, the logic for retention of ownership is substantially reduced. Unless there are intractable regulatory issues, there is therefore, some inevitability that the successful corporatisation will create a logic for ultimate privatisation.

146. As noted, the driving objective of reform has been to achieve productivity and efficiency gains. Privatisation, as mentioned above, is not an objective in its own right; the UK experience where privatisation actually proceeded management reforms in some cases has been seen by Australian governments and their advisors as putting the cart before the horse. A related issue is who should gain the reform premium: if the GBE is poorly run and there is obvious, immediate but unknown scope for gaining productivity and efficiency, there is no necessary reason why government should not undertake those reforms while learning the value of the business and then proceed to privatise. Privatising before the reforms have been comprehensively undertaken, not only minimises sales proceeds, but is likely to make the reforms much more difficult to implement.

Observations

147. The implementation of GBE reform in Australia has benefited from clearly articulated policies and frameworks. At the same time, the reform task is frequently complex and requires skilled analysis and advice. Unsurprisingly, not all market reforms have been equally well conceived or implemented. For instance, while the disaggregation of the former Victorian electricity and gas monopolies and associated

market reforms may set new standards, the disaggregation of the former water monopoly is viewed by many as problematic.

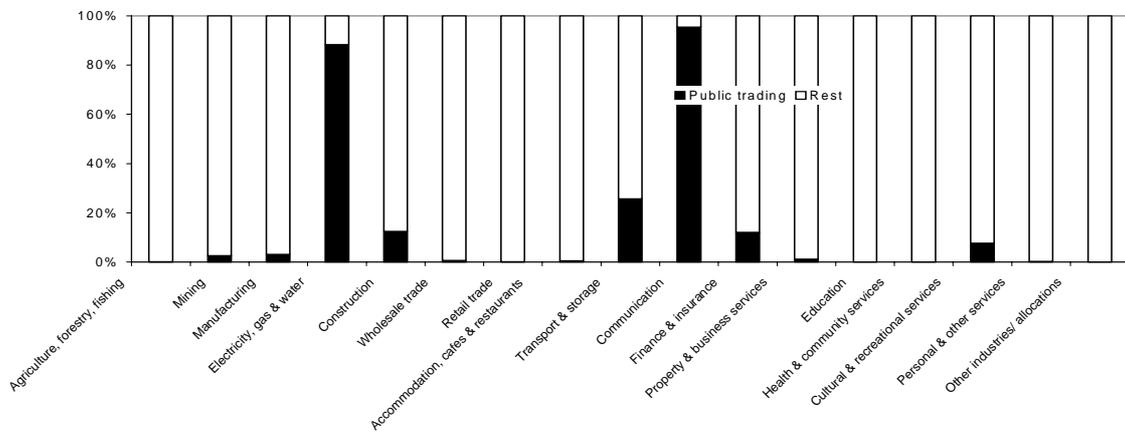
148. GBE reform has tended to focus heavily on the utility, transport and communication sectors. Some major GBEs have, to date, been left out. For example, workers' compensation remains a statutory monopoly in some States.

149. The caveats, however, are few and small in magnitude compared with the huge gains that have been made in GBE efficiency and performance to date. The process of GBE reform is, of course, far from finished. The National Competition Policy (NCP) reforms are only just beginning to be implemented in the GBEs themselves.

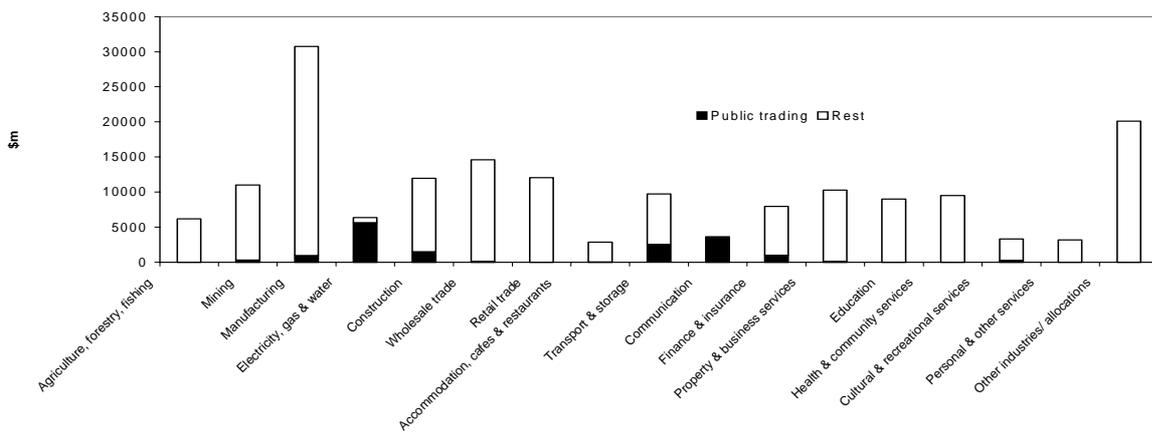
150. As part of the negotiations leading to the agreement on NCP, the Industry Commission undertook detailed analysis of the magnitude of the economic benefits estimated to accrue from introducing the policy. The cumulative effect of the reforms was estimated to provide annual gain in real GDP of around 5.5 per cent from implementing NCP and related reforms. Even if half this benefit is achieved, it would appear to be well worthwhile.

APPENDICES

Figure 1.2. Proportion of GDP at Factor Cost Accounted for by Public Trading Enterprises; 1982-83



Current Price Value

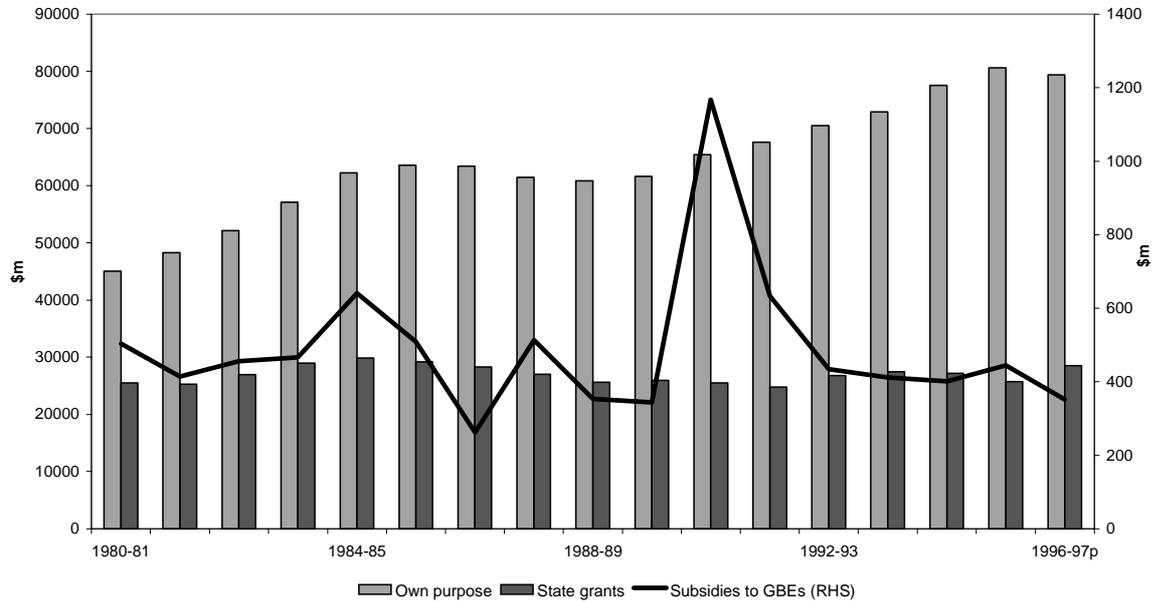


Note: Public enterprise product is the sum of public enterprise wages, salaries and supplements and public trading and public financial enterprise gross operating surplus.

Reforming Public Enterprises: Australia

Source: ABS Cat. No. 5204.0

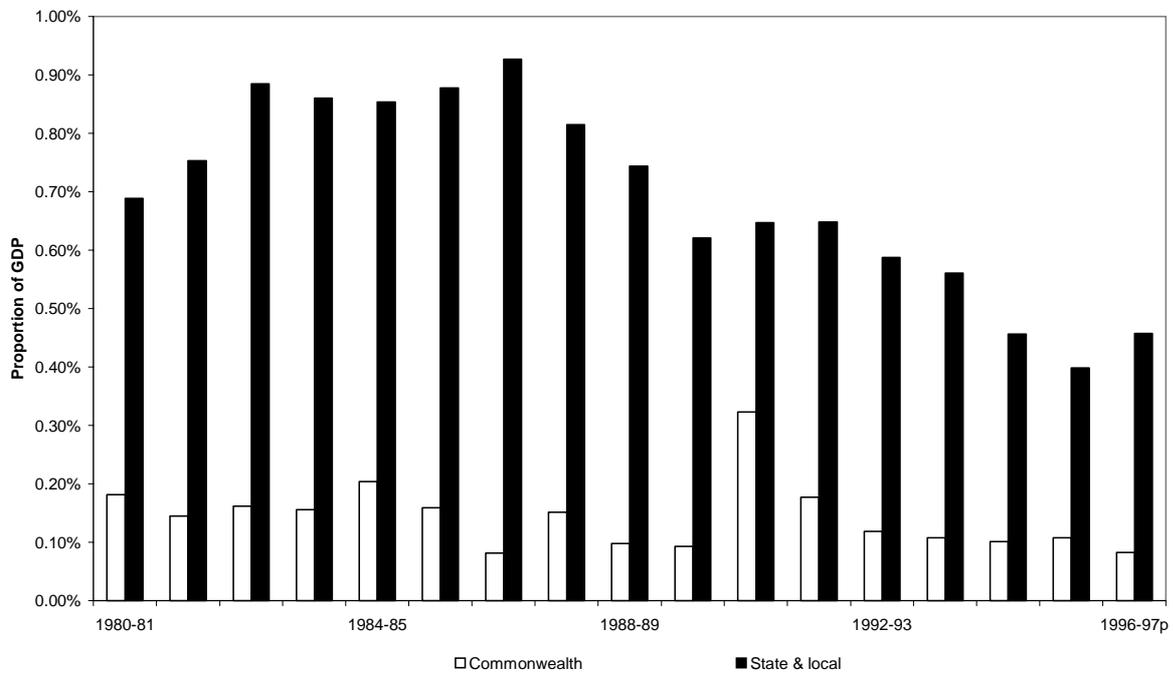
Figure 1.3. Commonwealth Outlays



Deflated by Underlying CPI

Source: ABS Cat. Nos. 5501.0 and 6401.0.

Figure 1.4. Net Payments to GBEs

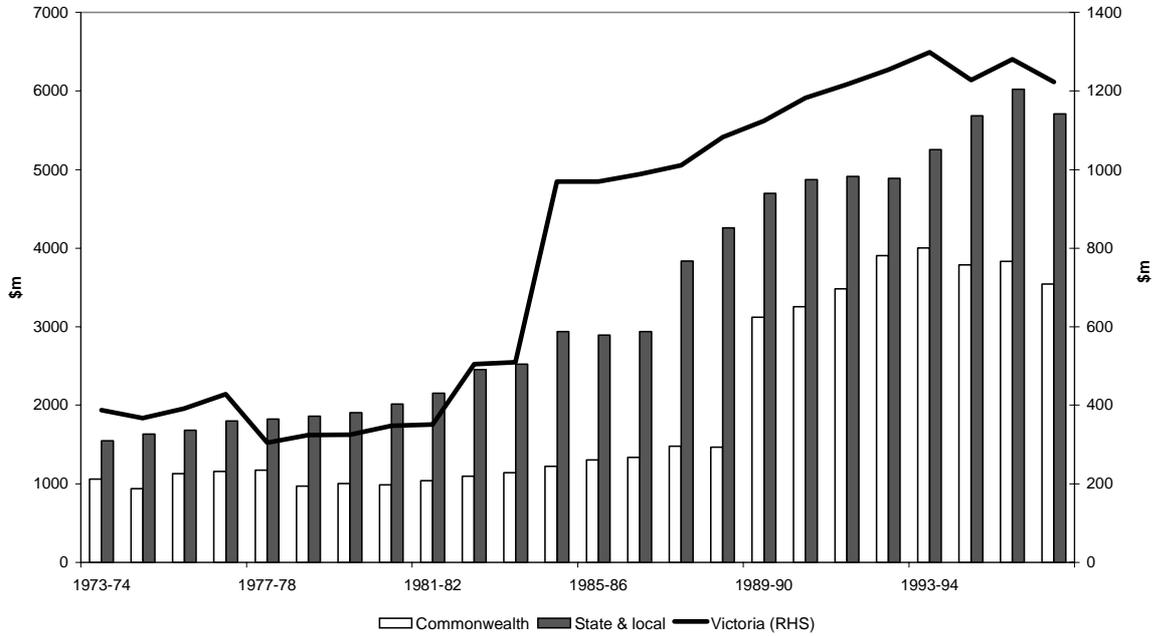


Deflated by Underlying CPI

Reforming Public Enterprises: Australia

Source: ABS Cat. Nos. 5501.0 and 6401.0.

Figure 1.5. User Charges; 1973-74 to 1996-97



Deflated by underlying CPI.
Source: ABS Cat. No. 5501.0

Figure 1.6. GBE Reform Strategies and Timing : Australia

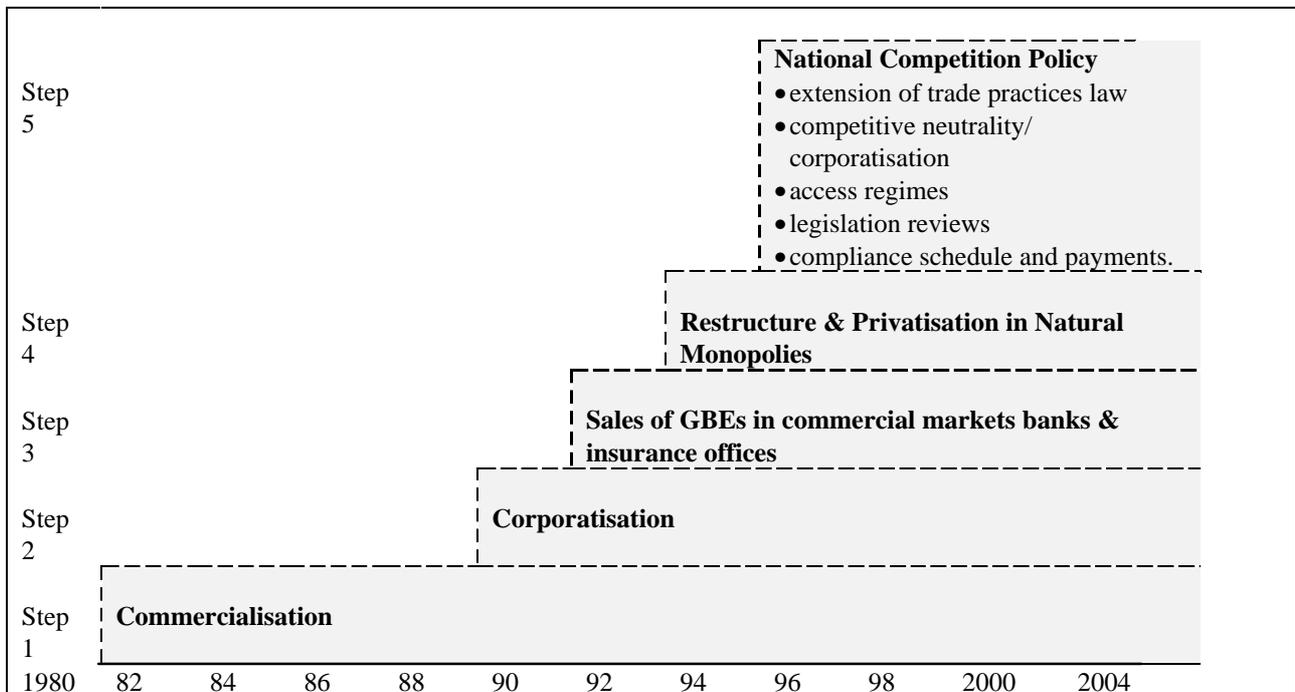


Figure 2.1. Efficiency of NSW GBEs in mid 1980s

- Massive operational inefficiencies in the major authorities including manning levels 20 per cent or more above realistic levels required for the work in hand;
- 8 per cent or 3 000 of the State Rail Authority (SRA)'s staff on "light duties" at a net cost of \$40 million per annum;
- The SRA's labour productivity was half that of many foreign railways due to factors such as inefficient work practices and absenteeism;
- In the Grain Handling Authority, some 81 separate restrictive work practices, some of which were described as demonstrating a "high degree of originality", were identified by a Royal Commission;
- The costs per kilometre for the Urban Transport Authority (UTA)'s bus operations are 50 per cent higher than benchmark costs even though the UTA's revenue and patronage is comparable to that achieved by other bus systems in Australia;
- Elcom's original design capacity exceeded the 1987 maximum winter peak demand by 73.5 per cent. While in normal circumstances this would have represented massive over-capacity, because of technical deficiencies and inefficient work practices, Elcom's low plant reliability (the lowest in Australia) due to meant that a reserve margin of 45-50 per cent was required. Even with such a high reserve margin, Elcom had over-capacity of around 25 per cent, representing, surplus investment in the order of \$2 billion.

Source: Steering Committee on Government Trading Enterprises, the "Sturgess Committee Report" 15 September 1988.

Figure 2.2. Government Business Enterprises Wholly or Partly Owned by the Commonwealth in 1996 & Current Status

NAME OF GBE	FUNCTION	STATUS
Australian Postal Corporation (Australia Post)#	Provides letter and parcel delivery services within Australia and internationally. It also provides a range of related services including: <ul style="list-style-type: none"> • electronic bulk mail handling; • advertising mail; bill payment, money order and banking services; and express delivery services.	Corporatised. The Government is the sole shareholder but has no explicit legal liability for any losses incurred. Only impact on the Commonwealth budget is through payment of taxes, and dividends and the repayment of capital. No sale plans although consideration is being given to making Aust.Post a company under the Corporations Law.
Telstra Corporation Ltd (Telstra)*	Provides telecommunications products and services for domestic and international consumers.	Corporatised. The Government has had no general explicit legal liability for Telstra. The Government has, however, acted as guarantor for loans taken out by Telstra. The Government has also guaranteed to cover any benefits that may have to be paid from the Telstra Superannuation Scheme in the event that the Fund or Telstra is ever bankrupted and wound up. To be one-third privatised by the end of 1997.
Defence Housing Authority (DHA)#	Provides housing for members of the Defence Force, offices and employees of the Department of Defence and other persons in order to meet the operational needs of the Defence Force and the requirements of the Department.	Independent and self-supporting. Not fully commercial as its primary purpose is to meet the needs of the Defence Force. Private sector borrowings by DHA are explicitly guaranteed by the Government. However, recently this guarantee has been weakened and no longer allows DHA to obtain discounted interest rates on borrowings. Now DHA lending risk is assessed on its own credit rating.
Australian Defence Industries Ltd (ADI)*	Produces a variety of defence products and services including military equipment such as weapons, ammunition and explosives. It also undertakes the repair, refit and modernisation of Navy vessels at its Garden Island facility and provides commercial and military engineering services.	In 1997-98, the Government is expected to consider the optimal timing for the sale of ADI – the means of sale and other sale issues will also be considered.
Commonwealth Funds Management Ltd (CFM)*	Mainly a wholesale funds manager providing investment services to a range of clients in both the private and public sectors. CFM is also involved in retail funds management through its approved Deposit Fund (which is now closed to new money) and the CFM Investment Fund and the CFM Retirement Fund.	Sold to the Commonwealth Bank of Australia (CBA) in 1996. CFM's subsidiary company, Total Risk Management (TRM) was also sold, to a different buyer, at the same time.

* Corporations Law company

Commonwealth authority

Figure 2.2 (cont.)

NAME OF GBE	FUNCTION	STATUS
Australian Industry Development Corporation Ltd. (AIDC)*	Facilitates the establishment, development and advancement of Australian industries, through the provision of finance and by participating in industries and projects.	Sold in 1997. Previously financially independent-- no government role in decision-making Since 1995 (following Government buy-out of minority shareholders) a wholly-owned subsidiary of the AIDC Statutory Authority. Through the Statutory Authority, the Government has acted as guarantor for AIDC borrowings. Existing guarantees remain in force, until maturity of loans.
Export Finance and Insurance Corporation (EFIC)#	EFIC is Australia's official export credit agency. EFIC's business covers three categories: insurance of exporters; concessional export finance to overseas buyers; and business undertaken in the national interest. EFIC is specifically charged with encouraging Australian financial institutions to participate in export financing.	The Government guarantees the due payment of money that is, or may at any time become, payable by EFIC to any person other than the Commonwealth. This contingent liability comprises contracts of insurance and guarantees, loans and national interest provisions. No plans to privatise.
Australian Technology Group Ltd (ATG)*	Provides capital to commercialise Australian research and technology. It has the related objective of ultimately raising private sector equity to participate in this process.	Financially independent, operating on a commercial basis. Established in 1993 through a once only government investment. No budget impact since, except for the payment of income tax. Government is 100% shareholder but dividends were not expected for 10 years. Government has explicitly stated that it accepts no liability for ATG and does not guarantee ATG borrowings or leases. Attempts by ATG to raise funds from the private sector to expand its capital base have not been successful. A recent review has suggested that Government should withdraw its investment from ATG and divest itself of ATG ventures.
Snowy Mountains Hydro-Electric Authority (SMHEA)#	Operates and maintains a hydro-electric scheme in the Snowy Mountains. The Scheme: <ul style="list-style-type: none"> • generates mainly peak and shoulder load electricity for use by NSW, Victoria and the Commonwealth (allocated to the ACT); • provides a major electricity transmission link between New South Wales and Victoria; • diverts water from the Snowy river into the Murrumbidgee and Murray river systems; and regulates the release of water for irrigation purposes. 	Oversighted and funded by the Commonwealth, NSW and Victoria. Not corporatised. Precluded from operating as a commercial venture. Explicit government guarantee of private sector borrowings. Currently being considered for corporatisation.

* Corporations Law company

Commonwealth authority

Figure 2.2 (cont.)

NAME OF GBE	FUNCTION	STATUS
Airservices Australia (Airservices)#	<p>Operates Australia's national airways system. Airservices' functions include:</p> <ul style="list-style-type: none"> • provision of air traffic services; • an aeronautical information service; • an aviation rescue and fire fighting service; • aeronautical communications; • an aviation search and rescue service; and • specified aviation environmental activities and regulation. 	<p>Corporatised. Government is 100% shareholder.</p> <p>Self-supporting, sells its services to the industry. No direct funding from Government. Government no longer guarantees borrowings and has no explicit liability.</p> <p>Government receives dividends approximating 60-65% of net profit after tax.</p> <p>Consideration is being given to making Airservices a company under the Corporations Law.</p>
ANL Ltd (ANL)*	<p>Provides both international and domestic shipping services and a range of shore-based shipping activities. The company provides container cargo services with six of its own ships and through arrangements with various partners.</p>	<p>Corporatised. Government is 100% shareholder.</p> <p>Currently budget impact is nil. Last equity injection in 1985. Last dividend payment received by Government in 1991.</p> <p>Government has guaranteed access to a promissory note facility. Government also explicitly guarantees all ANL major finance and operating leases and accepts liability for accumulated losses.</p> <p>For sale.</p>
Australian National Railways Commission (AN)#	<p>AN provides interstate rail passenger services, and intrastate rail freight in South Australia and Tasmania. It is developing operations involving its workshops and contracting services to other parties, principally the National Rail Corporation.</p>	<p>Sale expected to be finalised in Oct/Nov 1997.</p> <p>Until sale, AN had been corporatised with Government being 100% shareholder.</p>
Australian National Railways Commission (AN)# (cont.)		<p>Government has had no explicit liability for losses but, in practice, AN only able to borrow with Government guarantee. No Government guarantee on leases.</p> <p>Under Contract of Sale the Government has accepted responsibility for employee redundancies, superannuation, insurance claims, outstanding contracts and leases, loans and environmental remediation.</p>

Figure 2.2 (cont.)

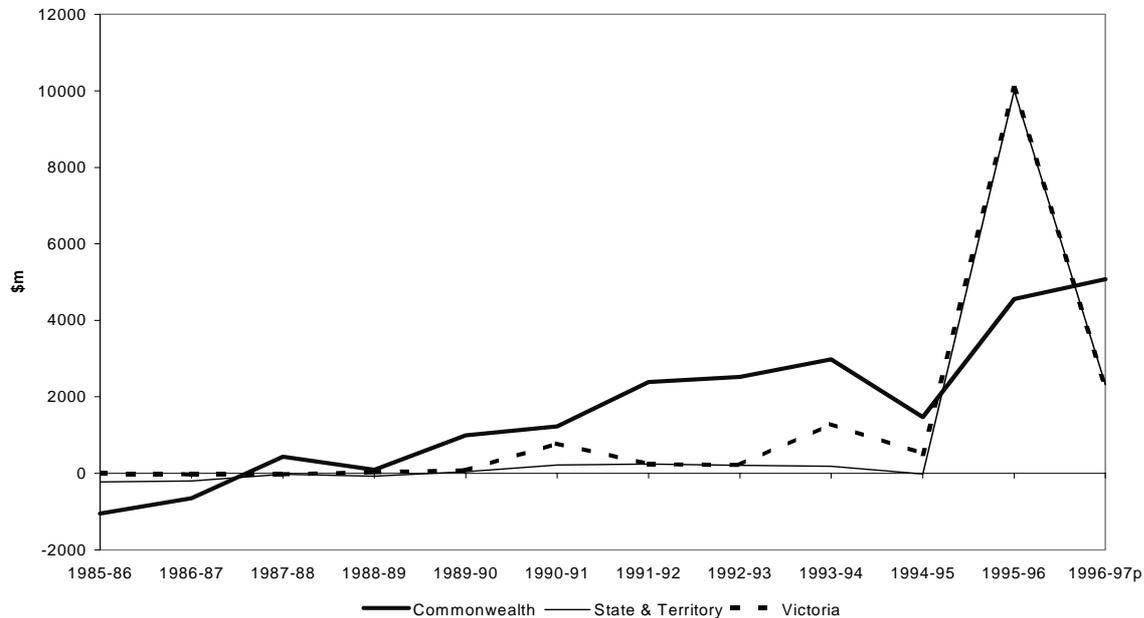
NAME OF GBE	FUNCTION	STATUS
Federal Airports Corporation (FAC)#	The FAC owns, manages and develops most of Australia's major airports.	Self-supporting. No direct funding from Government Budget impact limited to payment of income tax (since 1991) and dividends (equal to 40%-50% of net profit after tax). Government is implicit guarantor for borrowing. Melbourne, Brisbane and Perth airports sold to trade in mid 1997. Further sales forecast for 1997-98.
Commonwealth Bank of Australia (CBA)	The CBA is one of Australia's four major banks and provides a full range of banking services.	Now fully privatised Prior to privatisation, the Government guaranteed various liabilities of the CBA relating to both on and off balance sheet liabilities.
Housing Loans Insurance Corporation (HLIC)#	The HLIC insures lenders against losses on loans secured by mortgages, principally housing loans. HLIC's clients include banks, building societies, co-operative societies, credit unions and mortgage managers.	The Government explicitly guarantees all liabilities of the HLIC. Due to be converted into a wholly-owned Government company under the Corporations Law in September 1997. In the restructuring process certain liabilities and reserves of HLIC will be transferred to the Commonwealth.

Note: In the case of GBEs being prepared for sale, the Government has provided an indemnity to Directors and nominated officers. This is to indemnify them against all actions suits, claims, demands and reasonable costs and expenses incurred as a result of governmental or parliamentary inquiry and legal costs and expenses associated with the privatisation process and sale of shares. In some cases, such as with the sale of Commonwealth Funds Management Ltd, the Government also offered indemnities against losses and liabilities suffered by the purchaser as a result of the transfer of assets, rights, obligations or liabilities of the company; employment of staff and transfer of company shares.

* Corporations Law company

Commonwealth authority

**Figure 3.2. Net Asset Sales (Net Advances)–
Consolidated Government, 1985-86 to 1996-97**



Note: Figures for 1996-97 are forward estimates.

Source: Government Financial Statistics, Australia (ABS Cat. No. 5501.0)

**Figure 3.3. Sale Proceeds of Victorian Electricity Privatisation
(\$ million)**

	UNITED ENERGY LTD	SOLARIS POWER	EASTERN ENERGY LTD	POWERCOR AUSTRALIA	CITI-POWER LTD	YALLOURN ENERGY	H'WOOD/EBRIX	LOY YANG A ^(a)	TOTAL
Proceeds	1 553	950	2 080	2 150	1 575	2 426	2 357	4 746	17 837
<i>Composition of proceeds</i>									
Purchaser	471	248	430	554	355	575	142	1 134	3 909
repayments of TCV debt									
Equity return	735	533	1 095	990	638	656	1 133	3 612	9 392
Repayment of share-holder loans	339	156	359	467	232	847	456		2 856
Net State Equivalent Tax	..	11	189	137	338	79	487		1 241
Stamp Duty	8	2	7	2	12	269	139		439

Source: Department of Treasury and Finance (Vic) (1997) "Budget Statement 1997-98", Appendix A, p. 2.

Figure 3.4. Sale of Major Government Business Enterprises – Victoria

	DATE SOLD	SALE PRICE	PURCHASER
Heatane division of GFCV	May 1993	\$129.5 million	Elgas
TABCORP	August 1994	\$609 million	Public float
BASS – 50% sold	May 1995	\$3.3 million	Ticketmaster Corporation
SECV units:			
United Energy	September 1995	\$1.553 billion	Consortium - AMP/State Authorities Superannuation Board (NSW) / Utilicorp
Solaris	November 1995	\$950 million	AGL/Energy Initiatives joint venture
Eastern Energy	December 1995	\$2.08 billion	Texas Utilities Australia
Powercor	December 1995	\$2.15 billion	PacifiCorp
Citipower	January 1996	\$1.575 billion	Entergy Corporation
Yallourn Energy	April 1996	\$2.426 billion	PowerGen, ITOCHU, AMP, State Authorities Superannuation Board and Hastings Fund Management
Hazelwood/Energy Brix	September 1996	\$2.357 billion	National Power, Destec, PacifiCorp and others
Grain Elevators Board	May 1995	\$52.4 million	Vicgrian Ltd
GFE Resources	August 1995	\$56.2 million	Cultus Petroleum
Regional Ports:			
Portland	March 1996	\$30 million	Scott Group and Infracore Australia
Geelong	July 1996	\$50.5 million	Consortium – TNT Australia PL, Infrastructure Investment Corporation
Loy Yang B	April 1997	^a	Edison Mission Energy
Loy Yang A	April 1997 ^b	\$4.855 million	Horizon Energy
Melbourne Port Services	30 May 1997 ^b	\$7.735m	Skilled Engineering

a In December 1992, Mission increased its stakeholding to 51% from 40%. This raised its equity commitment to \$400m. As part of this increase holding, the government would not be required to establish a State-owned acquire an 11% interest in the station.

In April 1997, the government reached an agreement with Mission that would end a “take-or-pay” supply contract (saving estimated \$2b over 30 years), enter into hedge contract on aluminium smelter contracts (reduce estimated \$2b losses) and pay \$84m.

b Announced

Source: Department of Treasury and Finance; Media Releases by Premier, 11 December 1992 & 1 April 1997.

Figure 3.5. Reforming Victoria's Electricity Industry

Objective: To dismantle and privatise a State owned monopoly, and introduce competition into the electricity industry so as to provide efficiently produced, low-cost, secure electricity to businesses and households.

New Structure:

- **Generation** disaggregated into five independent companies which compete to supply electricity to retailers and large customers.
- **Retail and distribution** disaggregated into independent companies which compete to provide the network (substations and wires) through which electricity may flow, and the retail sale of electricity which includes billing and collection:
 - Five distribution businesses own and operate the low voltage, regulated monopoly distribution networks in the geographic areas defined by their distribution licences.
 - Each of the five distribution businesses is also the sole retailer of electricity to franchise customers in a defined franchise area, until those customers are able to choose from other retailers.
 - Barriers to entry for new energy retailing businesses have been removed and progressively electricity is also being supplied by independent licensed operators.
- **Transmission** separated from the wholesale market, system security and dispatch:
 - One statutory corporation (PNV) owns and operates, as a regulated monopoly, the high voltage transmission network. PNV is to be privatised by the end of 1997.
 - A second statutory corporation (VPX) operates as an independent, non-profit organisation and is responsible for minimising the cost of electricity by matching supply and demand under commercially competitive conditions while maintaining security and integrity of supply.
 - VPX also has a role in investment decision making, operating/administering the market for spot trading of electricity and representing the State in the National Electricity Market.

Features

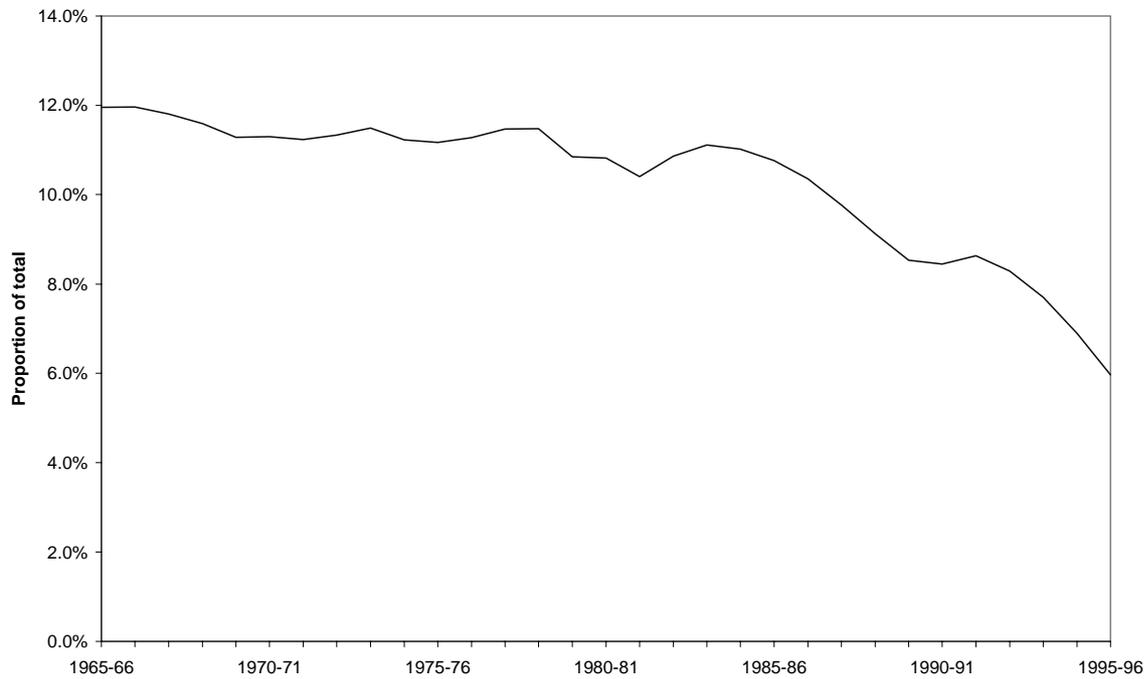
- Generators compete against each other to sell power into the wholesale market.
- Retailers compete against each other to supply contestable customers (which will comprise the entire market by 2001).
- All new material transmission investments are contestable- process managed by VPX.
- Distribution companies may be able to construct and operate new facilities outside their original geographic areas.
- A wide range of parties compete in several ways to mitigate risk associated with physical electricity market volatility.

Source: Department of Treasury & Finance (1997) "Victoria's Electricity Supply Industry – Towards 2000, Energy projects Division, June.

Figure 3.6. Transitional Staffing Arrangements – Examples of Diversity

ORGANISATION	UNION	RESULT FOR EMPLOYEES	CURRENT SITUATION
State Electricity Commission of Victoria	Covered by public sector union (Australian Services Union) who acted, on behalf of employees as the main bargaining agent, negotiating between the State Government and the private corporations. Union allowed to follow members to private sector.	No forced redundancies. Personnel, award conditions and super scheme all carried over to new corporations. Voluntary redundancies offered.	Union has Enterprise Agreements with all private corporations. Total staff numbers down from 14 500 at time of privatisation to 7 000. Increased use of contractors and outsourcing reduces union bargaining power – working conditions are expected to suffer.
Victorian Public Bus System	Covered by public sector union (Public Transport Union) until privatisation. After privatisation covered by a private sector union (Transport Workers Union)	All employees made compulsorily redundant. Able to apply, along with everyone else, for positions in new company but very few actually re-hired.	Union has an Enterprise Agreement with the National Bus Company. Employee numbers have dropped.
Commonwealth Department of Administrative Services – Driving Fleet	Covered by private sector union (Transport Workers Union) before and after privatisation.	All employees made compulsorily redundant. No special consideration was given by new company and very few were re-hired.	
Port of Portland	Prior to privatisation two public sector unions represented port employees (The Maritime Union – 80%, the Maritime Officers Union – 20%). They were the main agents negotiating with the Government on behalf of employees. Both unions have continued to represent their members following privatisation.	The unions secured a Memorandum of Understanding with the Government that guaranteed all existing terms and condition of employment. This Memorandum became part of the document and conditions of sale. As a result 30% of employees accepted Voluntary Redundancy and the rest were transferred to the new organisation.	Only a few employees have departed since privatisation so numbers have been fairly stable. Employees have experienced little difference in working conditions as a result of privatisation.

Figure 3.7. Proportion of Wages



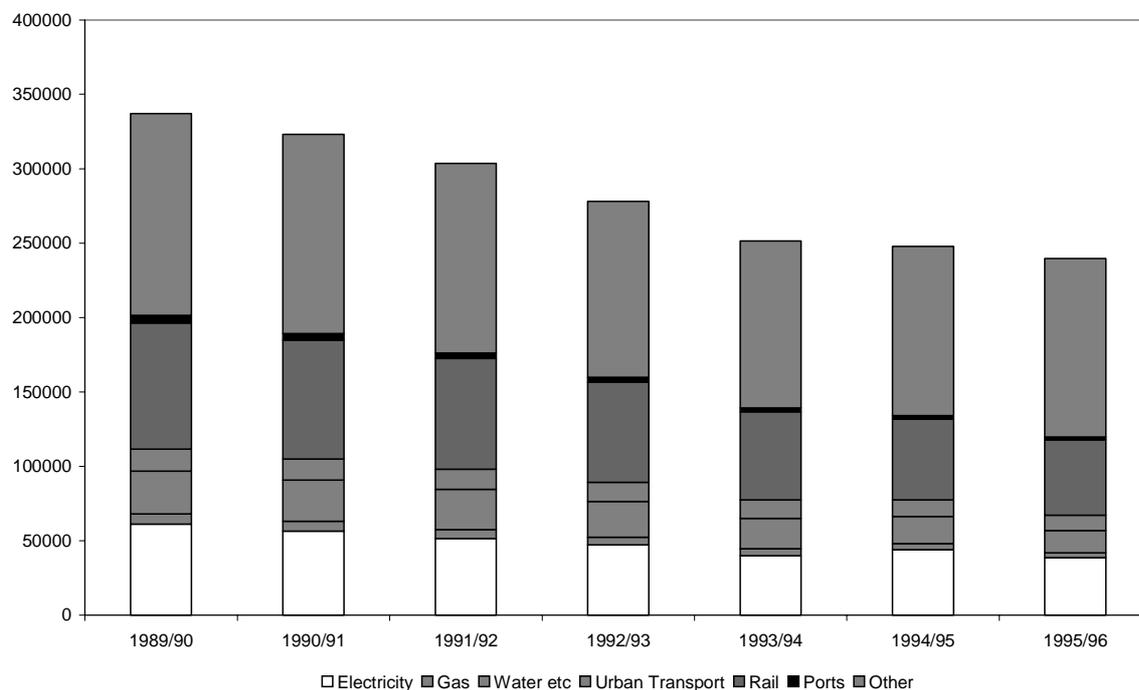
Source: *Australian National Accounts: National Income, Expenditure and Product 1995-96 (ABS Cat. No. 5204.0)*

Figure 5.1. Growth in GBE Total Factor Productivity :Australia
(% p.a.)

	1979-80 TO 1984-85	1984-85 TO 1988-89	1989-90 TO 1993-94
Electricity, gas & water	2.2	4.6	6.4
Transport & Storage	1.1	3.1	5.7
Communication	4.7	6.4	10.9
Non-farm private sector	0.6	0.6	n.a.
Manufacturing	1.3	2.2	n.a.

Source: *EPAC (1990), EPAC (1995)*

Figure 5.2. Employment in Selected Government Trading Enterprises^a, 1989-90 to 1995-96



a Reflects all monitored entities for last three publications. In the most recent report, 75 organisations were monitored. Lower employment does not necessarily equate with greater efficiency. This series does not incorporate constant service provision. Lower employment figures may reflect reduced employment in each organisation (either efficiency within the organisation or outsourcing) or the transfer of the activity entirely to private sector operation.

Source: Steering Committee on National Performance Monitoring of Government Trading Enterprises (various) Performance Indicators, Industry Commission, Melbourne.

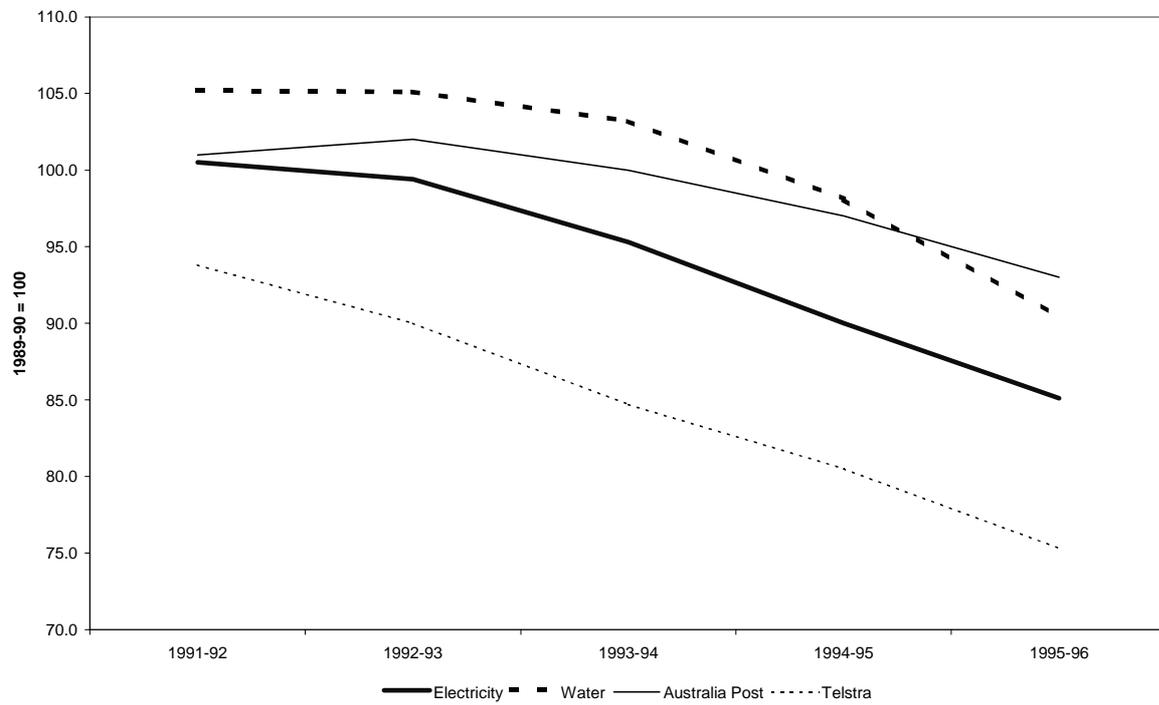
Figure 5.3: Gross Rates of Return for Trading Enterprises

	PRIVATE CORPORATE	PUBLIC
1982-83	12.6	3.8
1983-84	15.3	4.3
1984-85	16.4	4.7
1985-86	15.8	5.5
1986-87	15.0	5.7
1987-88	15.5	6.5
1988-89	16.1	6.6
1989-90	16.2	6.2
1990-91	14.8	6.6
1991-92	14.5	7.0
1992-93	14.6	7.1
1993-94	15.3	7.4
1994-95	15.9	7.7
1995-96	16.4	7.0

Note: Rate of return is Gross Operating Surplus divided by Gross Capital Stock.

Net rates of return are available but indicate inconsistencies in the depreciation estimates.

Figure 5.4. Price Indexes for Selected Industries



Source: *Steering Committee on National Performance Monitoring of Government Trading Enterprises*, Government Trading Enterprises, Performance Indicators, various.

Figure 5.6 : International Benchmarking Performance
 (Compared with Australian Best Practice)

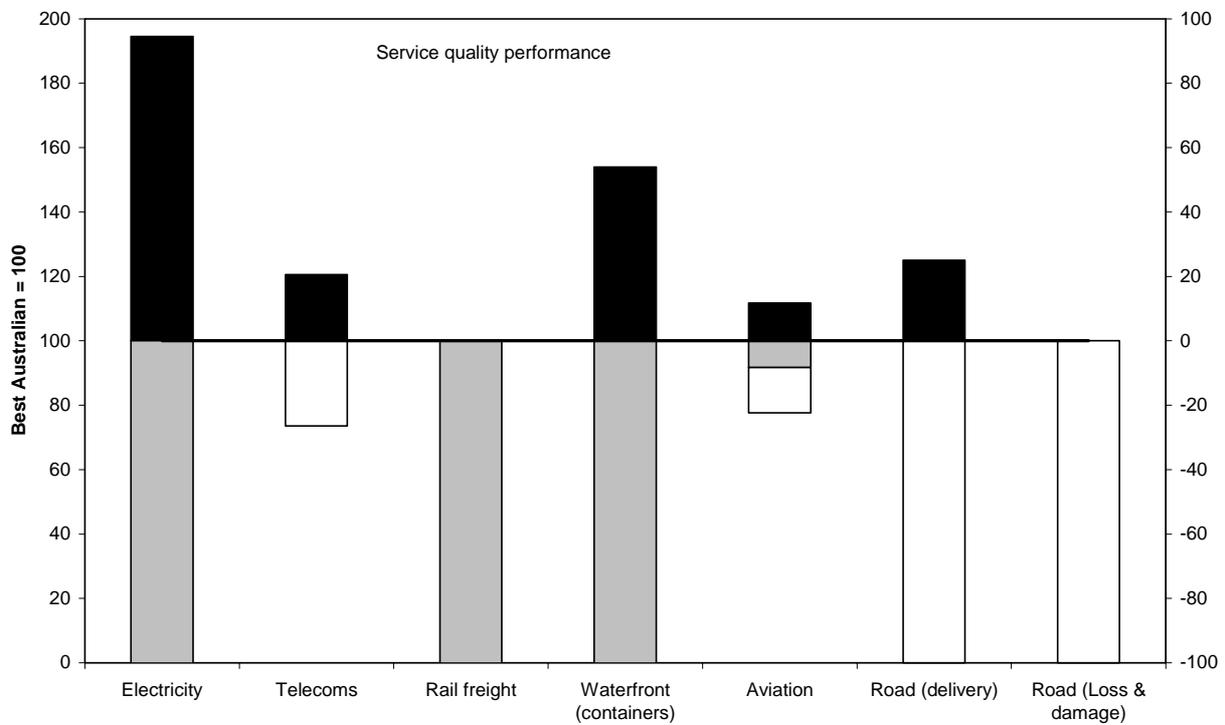
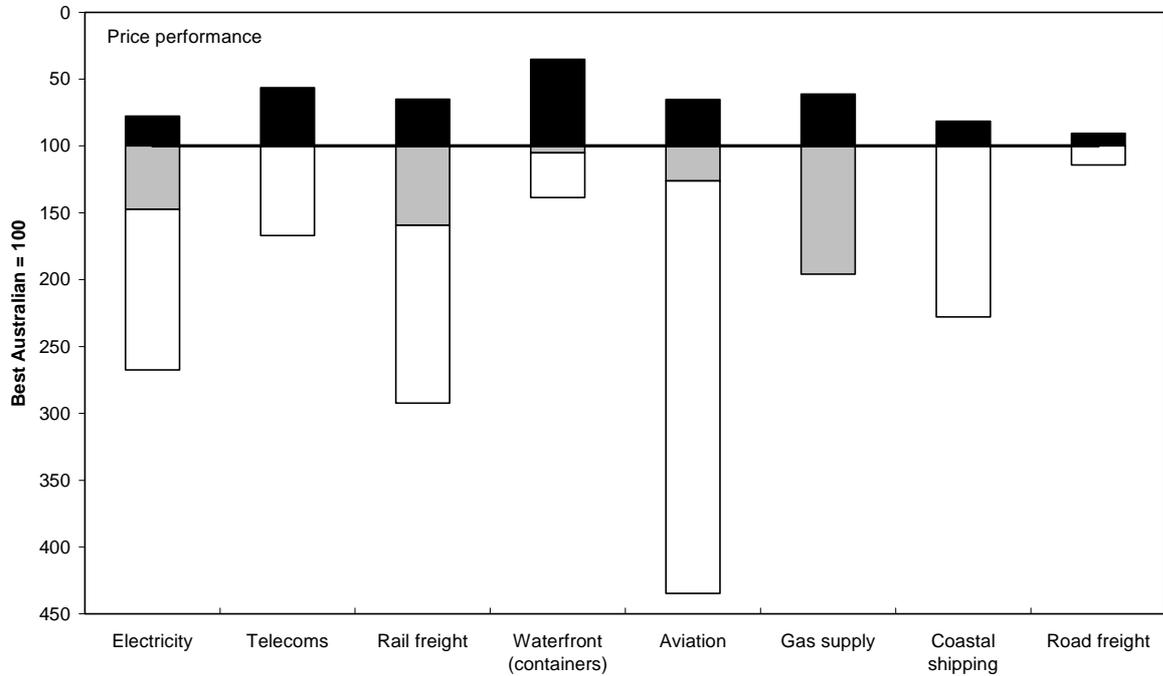
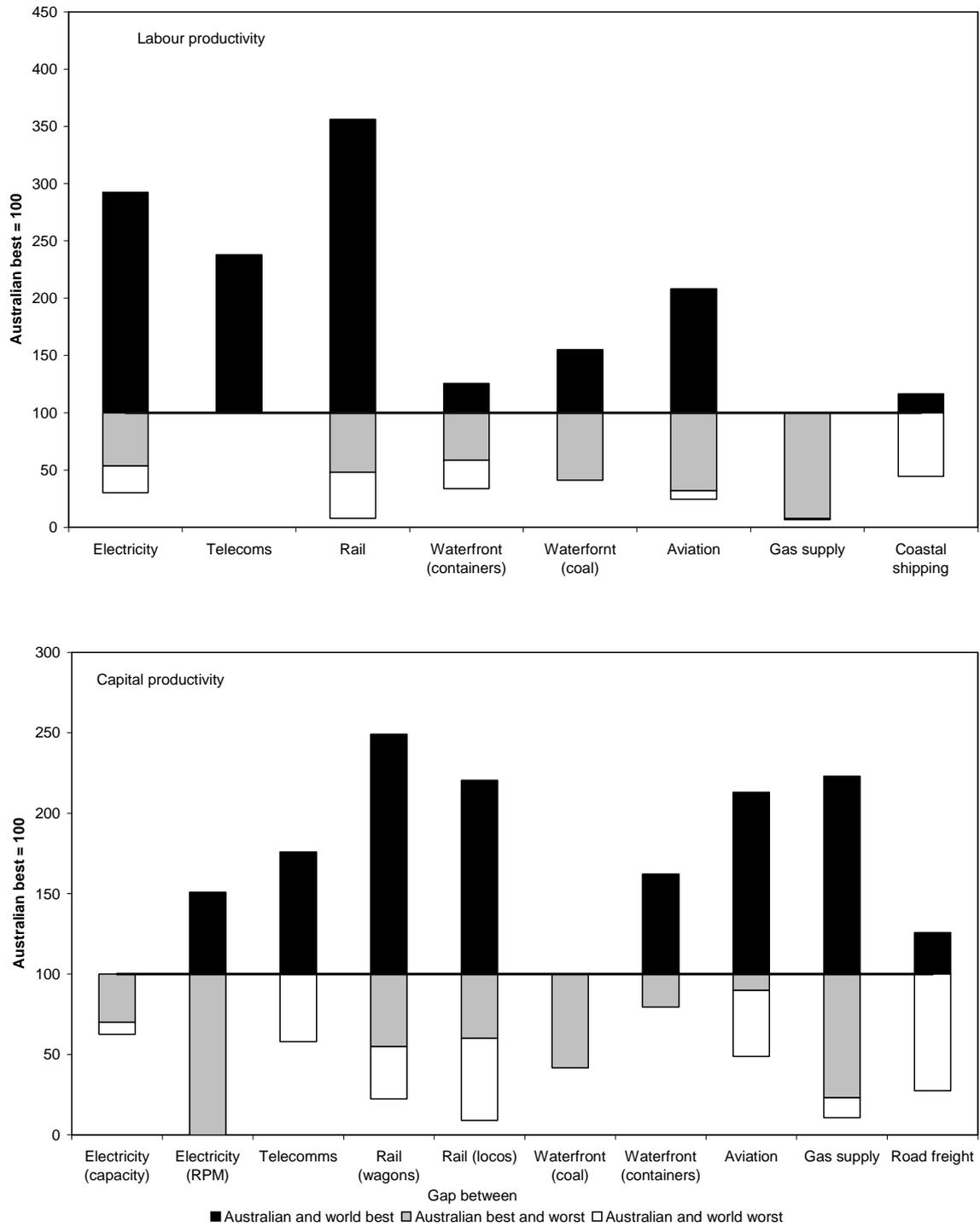


Figure 5.6. International Benchmarking Performance (cont.)



Source: BIE (1995) "Overview 1995: International Benchmarking" Report 95/20, AGPS, Canberra, November.

Figure 5.7. Comparison of 'No Privatisation' Scenario to Privatisation Outcomes
(Electricity Distribution Businesses, Yallourn Energy, Hazelwood Power/Energy Brix,
Loy Yang A and Loy Yang B Power Station) ^(a)

(\$ million)

	1995-96	1996-97	1997-98
No Privatisation Scenario			
Cash Inflows to Budget or SECV Shell ^(b)			
Dividends and State Tax Equivalents	140.6	346.7	439.1
Franchise Fees ^(c)	223.9	158.9	171.6
	364.5	505.6	610.7
Cash Outflows from Budget or SECV Shell			
Interest and finance benefits to Budget or SECV Shell ^(d)	207.7	258.0	258.0
MEU income entitlement	25	26.0	28.3
	232.7	284.0	286.3
Net Inflow	131.8	221.6	324.4
Privatisation Outcomes			
Cash Inflows to Budget or SECV Shell			
Dividends and State Tax Equivalents	..	62.0	..
Franchise Fees ^(c)	223.9	158.9	171.6
	223.9	220.9	171.6
Cash Outflows from Budget or SECV Shell			
Interest and finance obligations of SECV Shell ^(d)	67.7	-20.3	-135.0
MEU income entitlement	12.3
Budget sector interest cost savings	-91.3	-586.3	-736.1
	-11.3	-606.6	-871.1
Net Inflow	235.2	827.5	1042.7
Overall Financial Benefit to Budget and SECV from Privatisation			
	103.4	605.9	718.3

a) Inflows and outflows are to or from the budget sector and SECV Shell combined, and are limited to cash transactions arising from the privatised entities. 'Pass through' transactions involving offsetting debit and credit entries on TCV's balance sheet are ignored.

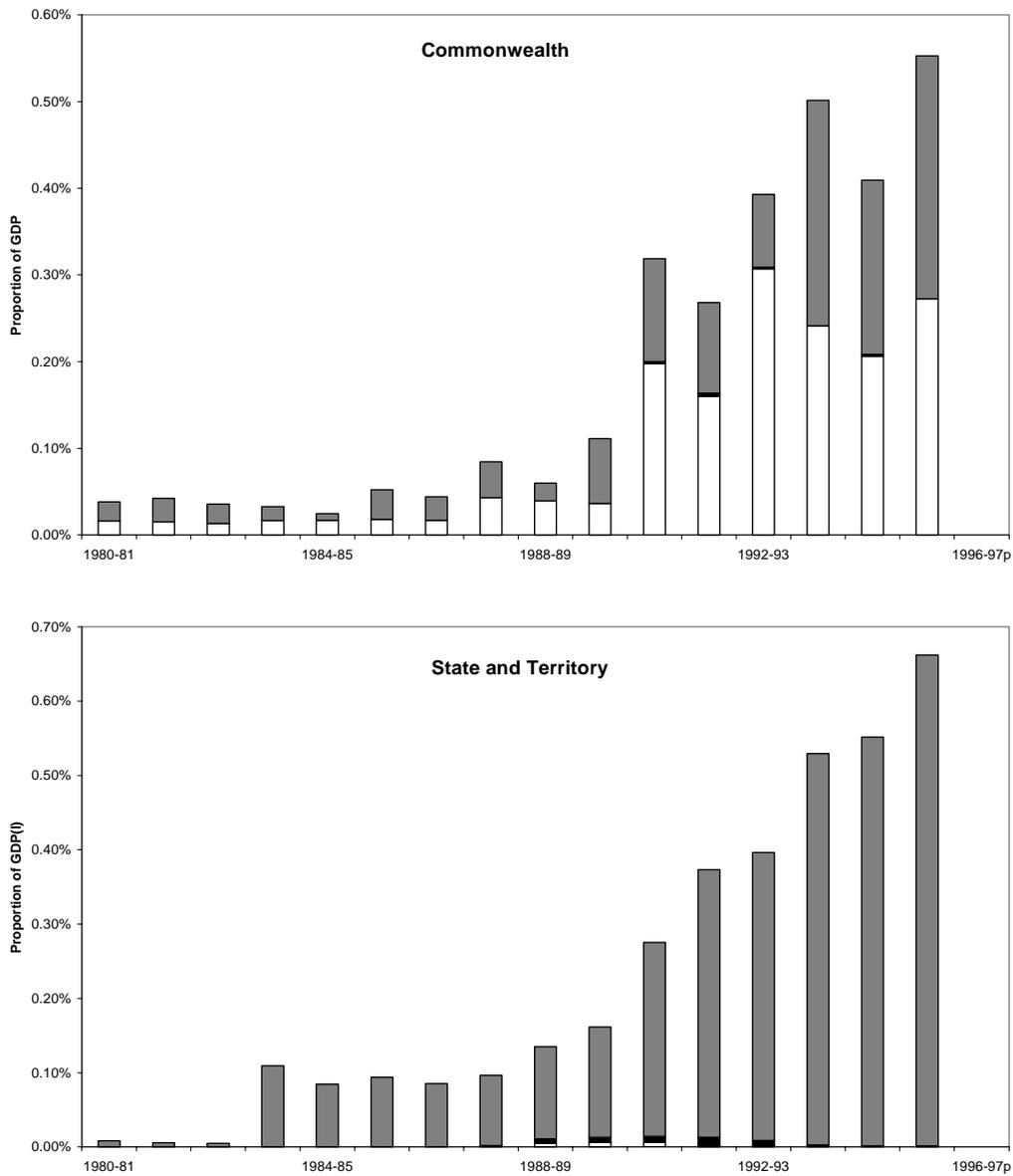
b) Derived from Distribution Businesses and Yallourn Information Memorandums Business Plans and financial modelling for privatisation case. For forecasting purposes a dividend payout of 65 per cent is assumed, except for Hazelwood which assumes 50 per cent and LYA which assumes 75 per cent.

c) Revised budget estimates.

d) TCV, entity and financial modelling estimates.

Source: Department of Treasury and Finance

Figure 5.8. Dividend and Tax Equivalent Payments



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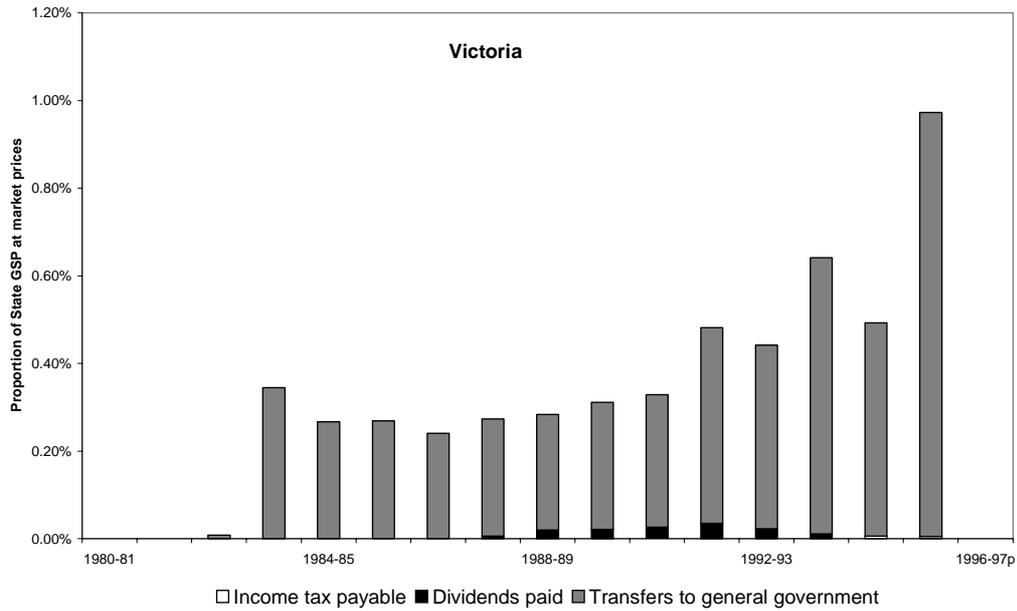


Figure 5.9. Subsidies to Public Trading Enterprises; 1973-74 to 1996-97

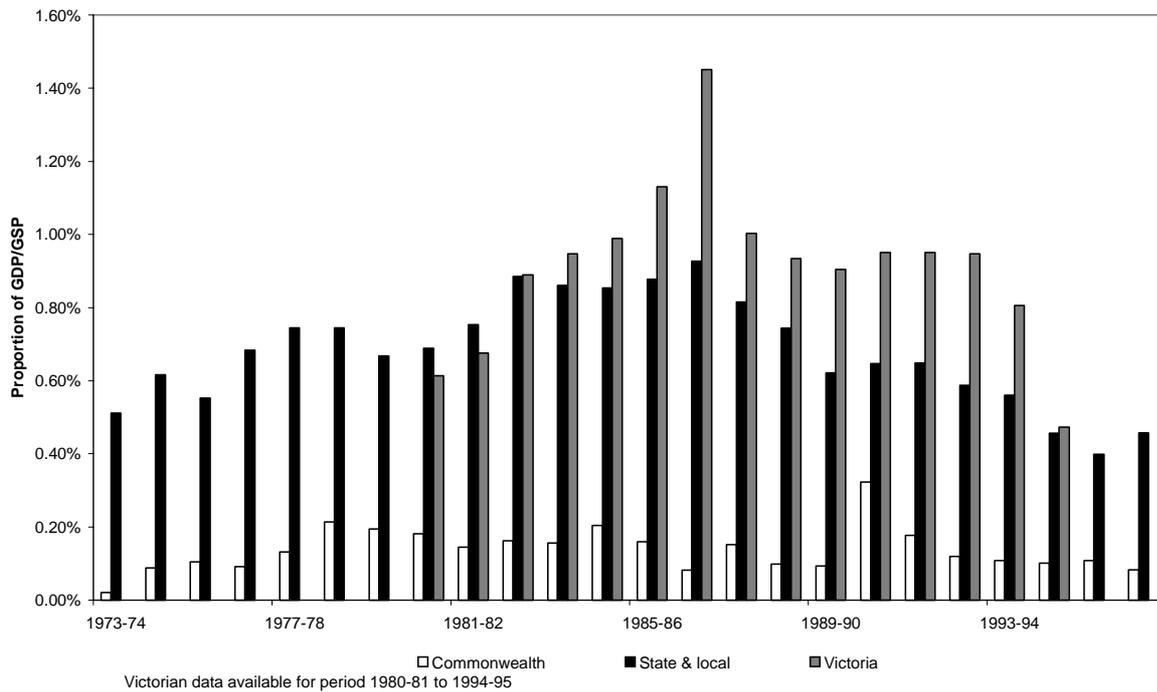
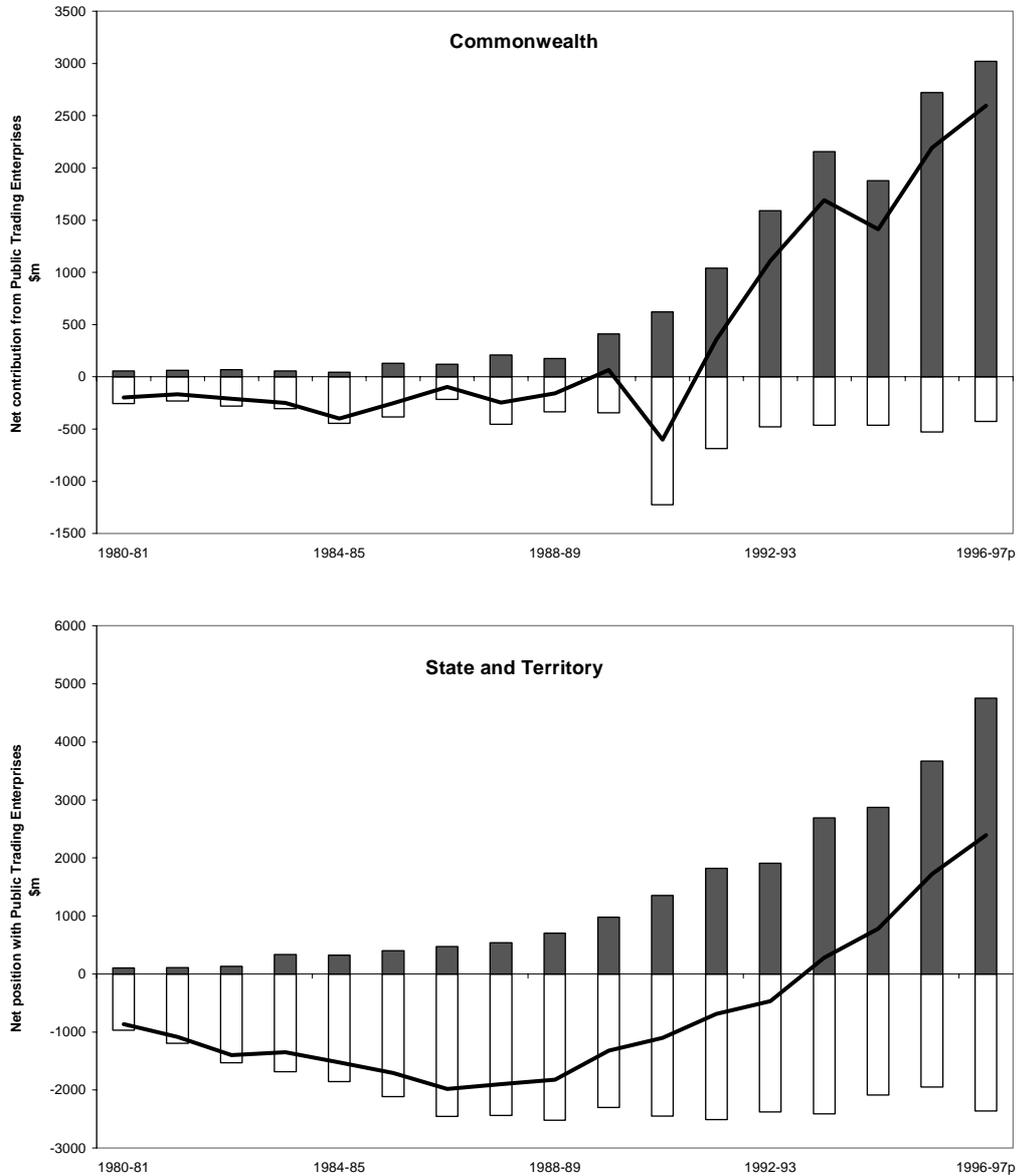


FIGURE 5.10. BUDGETARY IMPACT OF GBE REFORMS – NET OPERATING SUBSIDIES



Reforming Public Enterprises: Australia

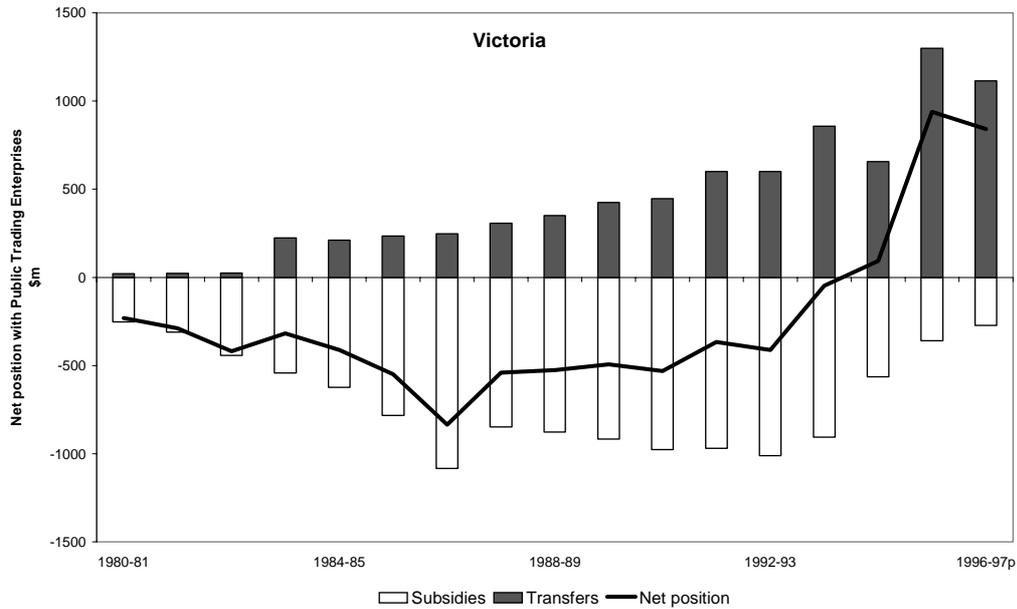
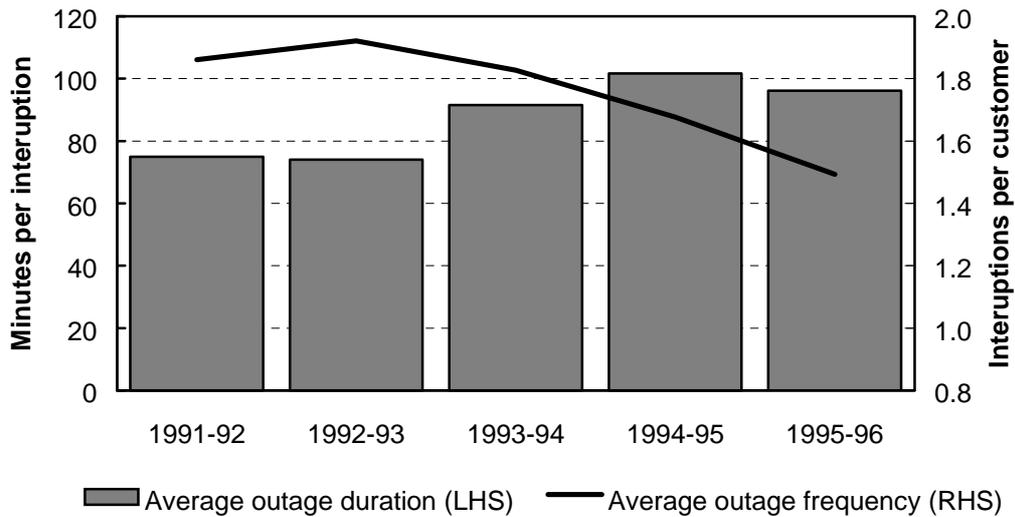


Figure 5.11. Average Outage Duration and Frequency



Source: Steering Committee on National Performance Monitoring of Government Trading Enterprises (1997) *Performance Indicators*, Industry Commission, Melbourne, p. 31.

NOTES

1. Please note that more in-depth figures can be found in the appendices.
2. At that time, corporations, taxation and trade practices law did not apply to GBEs.
3. Reportedly, 60 percent of engineering graduates were employed in these utilities in the early 1980s.
4. Steering Committee on Government Trading Enterprises (1988) "A Policy Framework for Improving the Performance of Government Trading Enterprises", Sydney, 15 September, p. 2.
5. The Murray Darling Basin Commission was established in 1985 as the successor to the River Murray Commission (established 1915). The Commissions were set up in recognition that no part of the basin could be dealt with in isolation. The later Commission broadened its responsibilities to include land use and environmental issues. [Murray Darling Basin Commission "The Murray Darling Basin Initiative", <http://www.environment.gov.au/portfolio/esd/csd/case6.html> 26 August 1997].

The Snowy Mountains Hydro-electric Scheme was established to provide irrigation and "environmentally friendly renewable electricity for New South Wales, Victoria and the Australian Capital Territory." [Steering Committee on National Performance Monitoring of Government Trading Enterprises, (1995) "Government Trading Enterprises, Performance Indicators: 1989-90 to 1993-94 – Vol. 2: Data", Industry Commission, Melbourne, April, p.60. The Snowy Mountains Hydro Electric (SMHE) Authority Corporation is under corporatisation and the successor to the Snowy Mountains Hydro-electric Authority (established 1949). This latter Authority was a Commonwealth statutory authority established to own and manage the SMHE scheme. Electricity is delivered to the entitlement holders Pacific Power – NSW (58%), the former SECV – Vic (29%) and ACTEW – C'wealth (13%) on a cost recovery basis. Following corporatisation, the organisation will be owned by the three respective governments in the same proportions as above. [<http://www.snowyhydro.com.au/corpinfo/profile.html>, 26 August 1997].

6. Quiggan, J., (1996) *Great Expectations: Micro Economic Reform and Australia*, Allen & Unwin, p. 103.
7. As noted, workers' compensation was provided by private insurers under state regulation until the mid-1980s when statutory schemes were established in NSW and Victoria.
8. EPAC (1987) "Efficiency in Public Trading Enterprises", Council Paper No. 24, AGPS, Canberra, January.
9. "State and Commonwealth Budgets, a comparative analysis, 1986-87" was produced by the IPA's States' Policy Unit headed by Les McCarrey, the former under-Treasurer for Western Australia. A consequence of this initiative was increased consistency and uniformity in the state budget presentations and the subsequent adoption by the ABS of uniform national accounts and the subsequent publication of Government Financial Estimates, ABS Cat. No. 5501.0 on a uniform basis.
10. "(O)vercapacity – poor capital investment decisions were made by the SCEV as a result of it misreading economic signals, inappropriate management incentives and political interference." Department of Treasury (Victoria) (1994) "Reforming Victoria's Electricity Industry: A Competitive Future for Electricity – A summary of reforms", Office of State Owned Enterprises, December, p. 18.

See also Chart 2.1.

11. The cost over-runs for the State Electricity Commission's new generator in the Latrobe Valley, Loy Yang A, were found by the subsequent Committee of Review to be 70% in excess of world best practice, with similar built-in excesses in the operating costs. Of the several commissioned consulting reports, see Rheinbraum Consulting (1982) "Cost Estimates and Management of the Loy Yang Power Station Project" December.

12. Press Release.
13. Industries Assistance Commission (1989), Government (Non-Tax) Charges, Report no.422, Canberra, 29 September.
14. *pers.comm.* former Head of Centre of Policy Studies, Monash University, Melbourne, August 1997.
15. *pers. comm.* former senior government advisor.
16. The Steering Committee on Government Trading Enterprises was chaired by Gary Sturgess, Director of the Cabinet Office. The framework built on, and eloquently, enhanced, thinking and experience behind the New Zealand State-Owned Enterprises Act (1986).
17. In turn, the paper by R.Cameron and P.Duignan (1984) "Government Owned Enterprises: Theory, Performance and Efficiency", presented to the New Zealand Association of Economists' Conference, Wellington, 21 February, is generally acknowledged as particularly influential in setting out the conceptual basis of the New Zealand reforms.
18. Government of Victoria (1984) Victoria: The Next Steps, April.
19. The competitive neutrality criteria was subsequently expanded so that later versions of these conditions refer to seven rather than five conditions.
20. Sturgess Committee (1988) "A Policy Framework for Improving the Performance of Government Trading Enterprises."
21. Commonwealth of Australia (1987), Policy Guidelines for Statutory Authorities and Government Business Enterprises, Canberra.
22. Michael Wilkins, Standard and Poor, speaking on Channel 9's Business Sunday and reported in *The Age* 14 July 1997.
23. Ivor Ries, Chanticleer, "Tax Chief Misses Jeff's Party," Australian Financial Review, 24 April 1995.
24. Ivor Ries, Chanticleer, "Grounding Airport Euphoria," Australian Financial Review, 8 May 1997.
25. The failures of the State Banks of Victoria and South Australia reflected very similar causes. Both began as State Savings Banks and essentially remained so until the mid 1980s. Following the deregulation of the banking sector in 1984, each of these banks moved into the new activities of corporate banking, established aggressive merchant banking subsidiaries and set balance sheet growth as their key objective. Uncertainty over the precise powers of the Reserve Bank to exercise prudential supervision of the State Banks combined with the collapse of the share market and subsequently the Australian property market led to the failure of both banks.

SBV was sold to the Commonwealth Bank in 1991 and SBSA was sold to Advance Bank in 1995.
Commonwealth of Australia (Wallis Committee) (1997) "Financial Inquiry: Final Report", AGPS, March.
26. Statement of Policy Intent on the Taxation Treatment of Government Trading Enterprises.
27. The (Hogg Committee) Committee of Inquiry into Sale of Electricity Assets Press Release 16 September 1997, "Summary" obtained independent financial advice that the sale would raise between \$22b and \$25b.
28. The Hon. Peter Costello, Federal Treasurer. Press Release, "Exempt Entity Assets that become Depreciable for Taxation Purposes", 4 August 1997.

29. Hilmer, F.G., Rayner, M.R. and Tapperel G.Q. (1993), National Competition Policy; Report of the Independent Committee of Inquiry, AGPS, Canberra.
30. Department of Treasury and Finance (1997), Principles of Competitively Neutral Pricing, Victoria.
31. Marsden Jacob Associates (1997) "Pricing Principles for Competitive Water Businesses".
32. BIE (1995) International Benchmarking Overview 1995 Report 95/20, Australian Government Publishing Service, Canberra, November, pp. xx-xxi.
33. *ibid*
34. Productivity Commission (1996), Electricity 1996: International Benchmarking, Report 96/16, AGPS, Canberra, September, p. xxii.
35. Bureau of Industry Economics (1995), Overview 1995 : International Benchmarking, Report 95/20, AGPS, Canberra, November, p. 108.
36. Bureau of Industry Economics (1995), Overview 1995 : International Benchmarking, Report 95/20, AGPS, Canberra, November, p. 108.
37. For an early critique of National Competition Policy see, King, S. and Maddock, R. (1996) Unlocking the Infrastructure : The Reform of Public Utilities in Australia, Allen and Unwin.
38. Sturgess Committee (1988), *op. cit.*
39. Government of Victoria (1997) Extract from Reforming Victoria's Gas Industry, June, p. 15.