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Tasmania

Tasmanian Government Submission:

Inquiry into the Privatisation of Regional Infrastructure and Government Business Enterprises

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1 Introduction

As outlined in the *Background Paper*[1] prepared by the House of Representatives Standing Committee on Transport and Regional Services (the committee), Tasmania has not undertaken extensive GBE infrastructure privatisation in the areas of particular interest to the Inquiry (namely the rail, road, aviation, ports, power and industrial manufacturing sectors).

In this context, the Tasmanian Government submission does not specifically address the Inquiry's terms of reference, rather it provides:

- an overview of the Tasmanian Government's framework for assessing whether GBEs should remain Government owned or be divested;
- two case studies outlining the impacts that specific privatisation programs have had in Tasmania and lessons learned; and
- an outline of a number of issues that the Tasmanian Government would like to see the committee consider when addressing the terms of reference.

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[1] House of Representatives Standing Committee on Transport and Regional Services (2003) Background Paper: *Economic and Social Impacts of the Privatisation of Regional Infrastructure and Government Business Enterprises in Regional Rural Australia.*

2 Tasmanian Government Business Enterprises

The government business sector is an important element of the Tasmanian economy. It delivers critical economic infrastructure for the State and provides substantial recurrent revenue to the Budget for redistribution back to the community. The strategic decisions taken, and investments made, by government businesses play a fundamental role in Tasmania's economic development.

The government business portfolio currently extends across many commercial markets including primary industries, port operations, transport, financial services, construction, forestry and energy industries.

In 2003-04, financial returns to the State from government businesses are expected to total $144.4 million — approximately 83 per cent of these returns are expected to come from the State's three electricity businesses (Hydro Tasmania, Aurora Energy Pty Ltd and Transend Networks Pty Ltd).

The current structure of the Government business portfolio reflects a history of past decision-making about the most appropriate basis on which Government-based activities should be progressed:

- some businesses are clearly fully commercial enterprises engaged in market conduct with private sector competitors (eg the ports);
- some businesses are corporatised entities that were once within the General Government sector (eg Metro Tasmania and The Public Trustee). The creation of these Government businesses was primarily driven by the desire to establish incentives for the efficient and effective delivery of services. A common feature of these businesses is the dependence on Community Service Obligation funding or other funding from the Government; and
- some businesses deliver a mixture of non-commercial and commercial services (eg The Public Trustee).

2.1 Rationale for Government Ownership

In general, there are four key objectives that guide the Tasmanian Government's decision when assessing the merits/benefits of retaining a portfolio of businesses:

- industry development;
- countering market failure;
- providing a source of revenue to the Budget to support the delivery of Government programs (through the creation of profit and the return of dividends to Government); and
- delivering 'community service obligations'.

2.1.1 Industry development

A major consideration in retaining a Government business in public ownership is that the business can be used as an indirect arm of Government policy to pursue industry development or infrastructure objectives.

Government-owned entities can be required, through their governance arrangements, to consider more than a purely commercial perspective and assist the Government to pursue wider goals. For example, the *Government Business Enterprise Act 1995* (GBE Act) states that one of the principal objectives of GBEs is to maximise the sustainable return to the State in accordance with each

GBE's corporate plan and having regard to the economic and social objectives of the State. As a further example, under the *Port Companies Act 1997*, the ports have two primary objectives: to facilitate trade for the benefit of Tasmania; and to operate in accordance with sound commercial practice.

2.1.2 Countering market failure

A common rationale for public ownership is that private ownership, in the face of market failure (such as market power or externalities), would lead to suboptimal outcomes. Government ownership, with an appropriate regulatory regime, could be considered more attractive than having private ownership with less accountability.

To some degree, this is relevant for the Tasmanian Government business sector. However, the market failure criterion is a relatively weak driver for retaining all Government businesses in the current portfolio given that the majority of businesses operate in competitive markets. Also, where market failure issues do arise, there are alternatives to public ownership to deal with these issues, for example, the adoption of a comprehensive regulatory framework.

2.1.3 Returns to the Budget

While total returns from the Government business sector only account for between six to seven per cent of total Budget revenue, these returns are highly important at the margin, given the largely fixed nature of Government expenditure commitments. From a Budget perspective, there is a need for a consistent and appropriate level of returns from each business. Businesses that consistently deliver low returns or experience considerable variation in earnings, contribute relatively little to the Government's Budget objectives.

2.1.4 Cost-effective delivery of community service obligations (CSOs)

The current CSO framework applies an avoidable cost methodology. The private sector may require a higher level of subsidy to provide the same activity, primarily to ensure a rate of return on capital invested.

One of the key concepts in the CSO framework is to minimise costs to the Budget. The net costs of delivering CSOs to Government can be significantly lower than the gross CSO costs, given the returns framework for Government businesses (i.e. payment of dividends and tax equivalent payments). Delivering CSOs through the private sector would increase the net costs of CSOs, although there may be some cost savings arising from efficiencies and contestability.

However, most Tasmanian Government businesses do not provide substantial levels of CSOs. The largest CSOs relate to electricity delivery (Aurora Energy and Hydro Tasmania) and public transport (Metro Tasmania) — smaller CSOs are provided by the Public Trustee (although CSO funding represents a substantial proportion of its revenue). Generally, the Tasmanian Government business sector operates on a fully commercial basis.

2.2 Rationale for Government Divestment

Whilst there are a number of reasons for divestment, the key rationale is to enable the Government to free-up equity in non-core investments and reapply those funds for the benefit of the Tasmanian community. Other reasons for divestment include:

- debt reduction;
- freeing up capital for other projects/uses;
- removing constraints associated with Government ownership;
- reducing risk;
- reducing administrative burdens; and
- changes in the business environment.

2.2.1 Debt reduction

The Government has set a net debt target of $1 billion for the Total State sector by 2008.

Currently, net debt in the Public Trading Enterprise (PTE) sector is around $1.76 billion, which is offset by $450 million in financial assets held by Public Financial Enterprises.

Another perspective is that net proceeds from divestments can be used to reduce General Government debt. However, unless a substantial proportion of assets were divested, it is likely that the net proceeds from a divestment strategy would have an immaterial impact on General Government sector debt.

It can be concluded that even a relatively substantial divestment program (leaving aside the electricity entities) is likely to have only a small impact on debt, either in the PTE sector or the General Government sector.

2.2.2 Free up capital for other projects/uses

The achievement of fiscal strategy targets requires continued financial discipline by the Government. The target of zero net debt in the General Government sector by 2008 means that a proportion of recurrent income will be used to repay/offset gross debt. This imposes a capital and expenditure constraint on Government.

It can be argued that equity in the Government business sector has a tangible opportunity cost – it can be released and used for other State projects (preferably of a capital nature) that would otherwise be unachievable given debt reduction objectives (proceeds for divestment should not be used to fund activities of a recurrent nature given that the proceeds are 'once off').

There are a number of critical infrastructure projects currently being progressed that may require strategic support from Government. There are also significant opportunities to advance the wellbeing of the Tasmanian community through higher levels of investment in social infrastructure. Realising equity through divestment enables the Government to be more strategic and accelerate its investments in areas such as public housing, childcare, and the continued development of the State's natural and cultural heritage, compared with the alternative approach of the gradual build up of assets funded from recurrent receipts.

2.2.3 Removing constraints associated with Government ownership

The Government's wider objectives (eg debt reduction) can impose constraints on Government businesses. For example, some Government businesses may be prevented from pursuing attractive business expansion opportunities by virtue of the Government's fiscal strategy targets, which impose debt constraints on the Government business sector.

Given the sheer size of the electricity entities within the portfolio, business strategies adopted in this sector could create debt constraints for the smaller businesses. Moving some of the small businesses outside the State sector enables decisions to be made by commercial boards in the best interest of the business (or within the portfolio of the shareholders), without reference to the constraints arising from Government ownership.

Transferring businesses to the private sector may also create additional scope for efficiencies, which will provide benefits to the businesses and their customers. Efficiencies could arise from enhancing economies of scale or scope of the acquiring party, or by the removal of constraints that prevent a Government-owned business from competing effectively with the private sector.

2.2.4 Reduced risk

The Government businesses operate in dynamic environments. Where traditional or captive markets are shrinking, businesses may seek to move into new markets or develop/deliver new goods and services. This typically leads to the assumption of higher levels of risk. Even where diversification is not a driving force, the high degree of change in the business environment gives rise to higher levels of business risk, often without supporting higher returns.

Increasingly, Government businesses are taking on more of an entrepreneurial role. The transfer of ownership from the public to private sector provides the opportunity to transfer business risk to those more willing to assume responsibility for risk, namely the market. This frees public capital for use in areas that cannot necessarily be commercially serviced by the market (eg public infrastructure).

2.2.5 Reductions in administration

Divestment of high risk businesses, businesses that deliver low value and returns and businesses that undertake functions that are non-core to Government, can reduce unproductive components of the Government business administration function and allow resources to be re-directed to those businesses which are delivering greater value and return.

Generally, smaller businesses carry greater risk, in the sense that a relatively minor change to the industry environment, or operating conditions, can have a material impact on business operations. Divestment of these businesses can generate real dollar administrative savings and also increase the time and resources allocated to considering high value creation activities, which may increase the total financial and economic returns to the State.

2.2.6 Changes in business environment

Markets are dynamic and rationales for holding businesses in Government ownership that were once relevant may no longer apply. For example, experience demonstrates that services that were once considered core to Government (eg building and maintaining roads) can successfully be delivered by the private sector. The experience built up by the private sector over recent decades means that the market is now considerably more mature and the risks to Government have significantly diminished.

3 Case Studies

The two case studies below outline a number of lessons and issues that the committee could consider when addressing and developing recommendations in relation to the Inquiry's terms of reference.

3.1 Rail freight

The Tasmanian Government Railways were first sold to Australian National in the early seventies, and then to Australian Transport Network (ATN) in 1998. Over this period very little capital was invested in infrastructure.

The Commonwealth Government sold a deteriorated and commercially unviable rail system. The state of the infrastructure, at point of sale, has had significant effects on business operations and, in particular, the ability to improve infrastructure facilities. While the private railway operator has been registering a profit, this has been achieved, to some extent, at the expense of infrastructure improvement.[2] In essence, resources invested back into the business have largely been used to support infrastructure retention, as opposed to improving assets or undertaking capital works to improve longer-term business operations and revenue streams.

While an analysis of past, present and projected rail infrastructure investment has not been completed in Tasmania, the apparent difficulties faced by Tasrail raise a number of questions about effective privatisation programs dealing with regional infrastructure in the rail industry. These include:

- whether adequate economies-of-scale exist in regional areas to ensure successful privatisation of long-term sustainable business operations;
- the state of the infrastructure at point of sale, and if it is in poor condition whether ongoing maintenance and improvement is commercially feasible; and
- how the 'spill over benefits' of safe and efficiently operating infrastructure (including job creation and environmental spin-offs from using rail rather than road) can be calculated into a fair and efficient sale and operating price.

3.2 Airports

Air services are the primary passenger transport over Bass Strait with 83 per cent of travel to and from the state in 2001/02 being by air. The infrastructure of the four main airports (Hobart, Launceston, Devonport and Burnie) is adequate for the current demand, and these airports are all operating with a small profit.

In 1990 the Commonwealth Government announced the transfer of regional aerodromes owned by the Commonwealth with a transfer grant and 'social benefit' subsidy (the Airport Local Ownership Program). The aerodromes were mostly unviable and in many cases small grants were soon expended on capital-intensive maintenance and upgrades.

Five Tasmanian airports were transferred to local ownership under this program (Strahan, Queenstown, St Helens, Flinders Island and King Island). The costs of operation of the Strahan,

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[2] It should be noted, however, that without a detailed analysis of the state-of-play of the business operations and strategies (past, present and projected) it is not possible to determine the potential impact that profit reinvestment could have, or has had, on the long-term sustainability of rail infrastructure.

Queenstown and St Helens airports exceed revenue annually by factors of approximately five times in some cases. The Queenstown airport has recently been de-licensed due to the high cost of upkeep, with services being redistributed to Strahan. Due to their low utilisation and the viability of alternative road connections the Strahan, Queenstown and St Helens airports received relatively small transfer funds from the Commonwealth under the Airport Local Ownership Program. Flinders Island and King Island received larger transfer funding, as locals, tourists and business travellers are almost entirely reliant on air travel for access to the islands. These aerodromes required much more capital input into upgrading and maintenance. However, both municipalities have very small populations and rate bases and are therefore not in a position to fund airport losses or heavy maintenance or upgrading costs.

King Island's aerodrome is almost economically viable, and therefore not a significant economic burden to the local community. However, Flinders Island's aerodrome is uneconomic, and a substantial financial burden on its local community. This makes ongoing maintenance difficult, and upgrades unlikely without increased traffic or some form of assistance. The Tasmanian and Commonwealth Governments provided substantial funding to the Flinders Council for the sealing of runway 05/23 at Whitemark airport in 1999.

Many parts of regional Australia are dependant on adequate, viable, reliable and sustainable regional services to ensure that impediments to access are reduced for locals, tourists and business travellers. Airports are critical for regional industry and development for a number of reasons (such as the increasing use of just-in-time-delivery and the general dependence on air for deliveries in regional areas) and it is critical that the Commonwealth Government recognises and supports an effective air service to regional Australia irrespective of airport ownership issues.

In addition to the Airport Local Ownership Program, the Commonwealth Government has introduced other reforms to the aviation industry that have so far failed to deliver their desired outcomes. For example, the deregulation of, or the opening of access for, international airlines to regional airports in all air services negotiations, for both freight and passenger services, has not resulted in any international airlines accessing Hobart airport through the Regional Package.

Some of the privatisation processes/reforms that have been implemented in the aviation industry and related industries/infrastructure have had significant impacts on regional and isolated economies such as Tasmania. Key lessons that can be drawn from these reforms that relate to the privatisation of airports include:

- the importance of establishing clear objectives and outcomes from privatisation;
- the importance of regularly monitoring the impact of privatisation programs; and
- the importance of developing a flexible fit-for-purpose privatisation program — rather than one that is nationally consistent, which disadvantages certain regions.

4 Issues Relating to the Terms of Reference that Require Consideration or Analysis

The Tasmanian Government would like to see the committee address and/or consider a number of issues under the key Terms of Reference.

In relation to **policies, measures and other factors that would assist in developing world-class infrastructure** it is recommended that the committee consider:

- whether developing world class infrastructure should be a core objective or whether the focus should be on developing infrastructure appropriate to the needs of the community (including social, environmental, and economic needs);
- as a corollary to the above point, the need for infrastructure to be developed in a strategic way, and to include consultation with all levels of government and other stakeholders;
- the need to establish clear objectives and outcomes for privatisation programs; and
- the importance of developing flexible fit-for-purpose privatisation programs rather than nationally consistent programs that disadvantage certain regions.

In relation to the **role of three levels of government and the private sector in providing regional infrastructure** it is recommended that the committee consider:

- that solutions that work in major capital cities are not always appropriate in regional Australia;
- the level of assistance or incentives that the Commonwealth can provide to make investment in regional Australia attractive to private businesses, particularly where there are no economies-of-scale;
- the role of public private partnerships in providing regional infrastructure, and the need to assess who is best placed to provide value for money, quality of service, and manage risks; and
- as a corollary to the above point, developing a guide/framework to assist the three tiers of government work to together on significant privatisation programs so that the initial and ongoing roles and responsibilities are clearly understood from the start of the process.