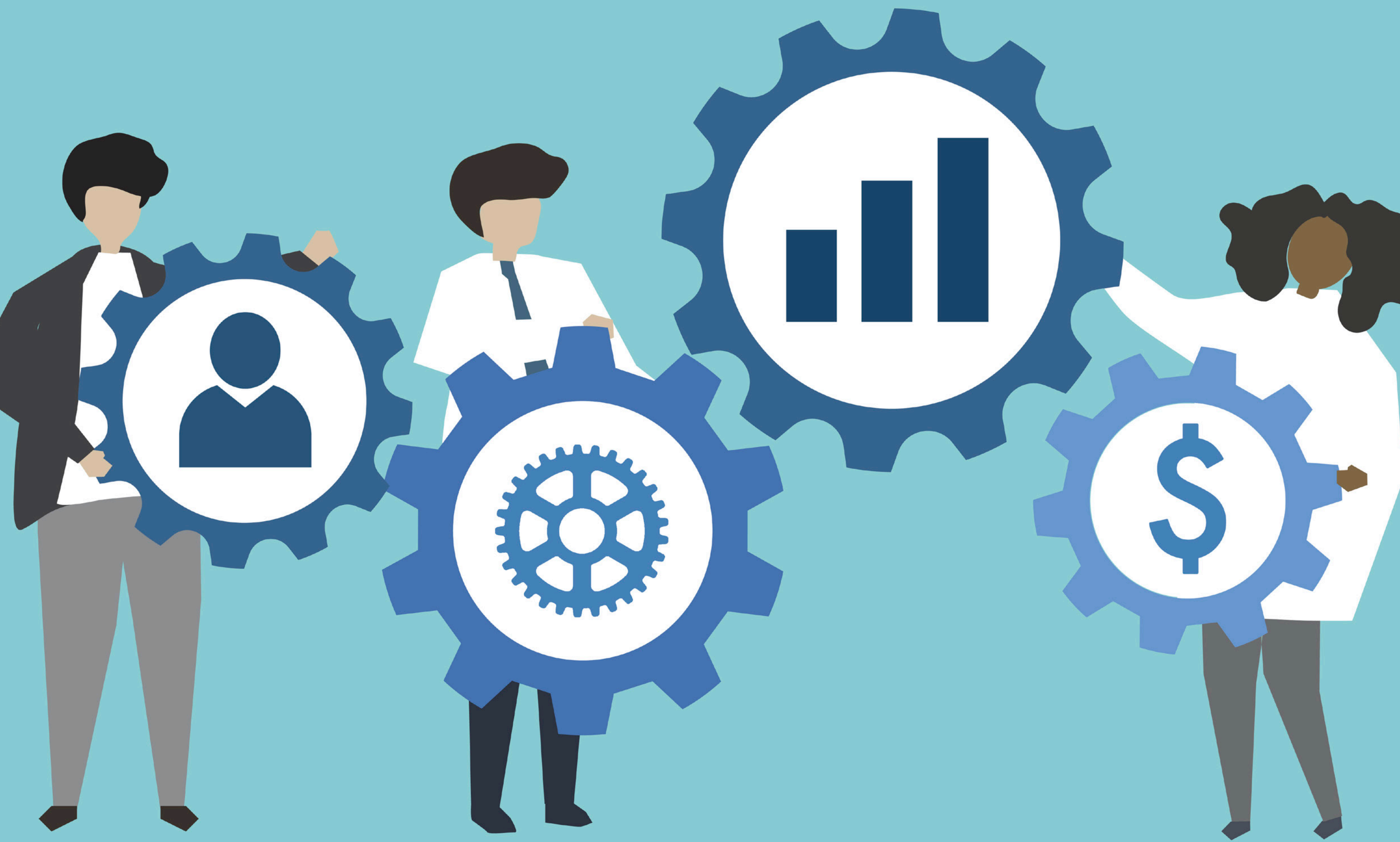
POLICY PAPER

No. 23 • September 2019

Reform, Retreat and Relinquishment

Lessons from historic state ownership of businesses in NSW

Percy Allan AM



TARGET30
REDUCING THE BURDEN FOR FUTURE GENERATIONS

THE CENTRE FOR INDEPENDENT STUDIES

NATIONAL LIBRARY OF AUSTRALIA

A catalogue record for this book is available from the National Library of Australia

Reform, Retreat and Relinquishment

Lessons from historic state ownership of businesses in NSW

Percy Allan AM

TARGET30
REDUCING THE BURDEN FOR FUTURE GENERATIONS

THE CENTRE FOR INDEPENDENT STUDIES

POLICY Paper 23

Contents

Introduction

In the 1980s and 90s, Australian governments agreed to an ambitious program of micro-economic reforms to lift industrial productivity and living standards that had languished in the 1970s and 1980s.

Most economic attention on that era has focused on federal government initiatives such as further reducing import tariffs, floating the Australian dollar, exposing local banks to foreign competitors, deregulating the telecommunications industry, adopting enterprise wage bargaining, and privatising AUSSAT (now Optus), Telstra, Qantas, the Commonwealth Bank and CSL.

However, significant reforms of government owned businesses occurred at a state level, which resulted in a massive boost to their efficiency and releasing scarce resources for core 'general government' services such as public education, health and community services.

This research paper explains the key structural reforms that made the 1990s the 'Golden Era' of transformation for NSW government businesses. It also explores possible reasons for those gains waning in the early 2000s (before the NSW government ceased publishing performance reports on the sector). Finally, it traces the shift to privatise NSW government businesses — especially in the 2010s — and the reasons for so doing.

In conclusion, it asks what these three decades of reform, retreat and relinquishment of government enterprises in NSW teach us about the role of government in future.

Bureaucracy versus businesses

In the 1980s and 1990s, the NSW public sector consisted not only of a general government agency sector, but also a large government-owned businesses sector. The general agencies were administrative bureaucracies primarily funded from the government's annual operating budget (i.e. state taxes and federal grants), enjoyed an exclusive franchise (i.e. monopoly privileges) and were controlled directly by a Minister who was accountable to Parliament for their operation and performance. They included ministerial departments that oversaw public hospitals, schools, vocational education colleges, roads, courts, police stations, prisons, fire stations, community services and a myriad of other subsidised activities.

By contrast government businesses were mainly funded from their own revenues (client charges)[1], could be exposed to market competition, were controlled by a board of directors which in the case of State Owned Corporations (an important subset of government businesses) were accountable to two Shareholding Ministers (one of whom was the Treasurer) for financial performance and a Portfolio Minister for community service obligations and industry regulatory compliance (e.g. environmental, health and safety). 'Community service obligations' was code for politically-driven services — such as providing free walking tracks or picnic benches in state-owned forests used for commercial logging.

Government businesses took three forms:

- Public Trading Enterprises: PTEs (e.g. State Transit Authority, State Rail Authority, Sydney Catchment Authority);
- State Owned Corporations: SOCs, which were a subset of PTEs (e.g. Sydney Water Corp, Newcastle Port Corp, NSW Landcom); and
- Public Financial Enterprises: PFEs (e.g. State Bank, GIO, NSW T-Corp, Fair Trade Administration Corp, FANMAC Trusts).

The PTEs were public sector entities that engaged in trading activities for which they charged a fee. If a PTE performed a 'community service obligation' it was meant to be paid a fee by the government so as not to compromise its commercial culture and intent. Otherwise it would cross-subsidise political aims at the expense of its commercial goals.

PTEs underwent a 'commercialisation' drive to varying degrees. Some PTEs graduated to becoming SOCs.

The State Owned Corporations Act 1989 (SOC Act) provided for both company and statutory SOCs, but only the latter existed at the time. Statutory SOCs were not subject to the Corporations Act, though some of the Act's provisions were included in the SOC Act. SOCs were public enterprises that had been 'corporatised' to mimic public-listed companies.[2]

The Statement of Corporate Intent (SCI) was an annual agreement — between Shareholding Ministers and a SOC Chair and CEO — on the corporation's financial targets and capital program. A Statement of Business Intent (SBI) was the equivalent of the SCI for non-corporatised businesses. The contract was between the Treasurer (as the shareholding minister), Portfolio Minister (as the regulator and community service supervisor), the SOC, Chair and its CEO.

Government businesses were meant to operate like private enterprises, not like government departments. Each business was meant to earn a minimum rate of return on its capital, which reflected its business risk. The minimum rate was a function of the mix of equity and debt that comprised its capital. A consistent methodology was used by the NSW Treasury to calculate each business's weighted average cost of capital (WACC), just as a publicly listed or private corporation would do.

Government businesses (unlike general government agencies) were meant to earn their own keep, except for any social obligations imposed on them by the government — for which they were entitled to charge a fee to cover the cost, so it did not detract from their obligatory minimum capital return.

Notwithstanding the divestiture of the State Bank and Government Insurance Office (GIO), NSW government businesses by June 2010 still owned $116 billion of physical assets; accounting for almost half the non-financial assets of the state sector as a whole (NSW Treasury, 2010). At that time, the net worth (total assets less total liabilities) of NSW government businesses was $79 billion — which far exceeded the $49 billion worth of the BHP Billiton Group (BHP, 2010).

Government businesses contributed over $1.8 billion a year of dividends and taxes to the State Treasury's coffers, but received over $5.7 billion a year of grants and subsidies in return. Most of these were operating subsidies and capital grants for public transport (railways, buses and ferries).

Commercialising Government Businesses

With the election of the Greiner (Coalition) government in March 1988, a concerted effort was made to accelerate the commercialisation and corporatisation of government businesses, which had advanced haphazardly. A formal framework was adopted to clarify the principles and pathway that would define the desired changes in the way government businesses were to operate.[3] New Zealand had already gone down this path, so NSW drew on its experience to enunciate a model that other states (and the Commonwealth) largely replicated.[4]

The ultimate aim was to 'corporatise' all government businesses. The goals of 'corporatisation' were to achieve productive and allocative efficiency.

Productive efficiency (an engineering concept) involved producing the maximum output (goods and services) with the minimum input (resources). It meant using productive assets so as to maximise their commercial (i.e. market) value. After all, businesses were meant to be businesses — not charities. If government wanted them to perform social (non-business) functions, it would need to pay the same amount it would pay a private enterprise for such a service.

Allocative efficiency (an economic concept) required producing the right mix of goods and services to maximise consumer satisfaction. This was to be achieved by selling goods at their true cost of production, and exposing them to price competition so as to avoid price gouging.

The Corporatisation Framework stipulated five operating principles for government businesses:

1. Clear and non-conflicting objectives
2. Managerial responsibility, authority and autonomy
3. Independent external performance monitoring
4. Rewards and sanctions for performance
5. Competitive neutrality in all markets

The framework recognised that government businesses would first need to be 'commercialised' before they could be 'corporatised'. Commercialisation simply meant achieving the first four steps — not the fifth, which entailed stripping a business of any monopoly privileges and subjecting it to market competition. In other words, a government business had to learn how to become commercial (i.e. make a profit on its own) before it could be corporatised (i.e. exposed to private or voluntary sector rivals).

In essence, commercialisation involved achieving *productive* efficiency (by reducing unit costs of production), while corporatisation sought *allocative* efficiency (by de-monopolising the business so consumers could choose alternative suppliers if the service was too expensive or inadequate).

Hence, corporatisation in NSW government jargon did not mean or necessarily involve incorporation (i.e. becoming a public company under the Australian Corporations Legislation). It had more to do with exposing a government business to real competition in its service delivery, labour hire, and supply and equipment procurements.

A summary of the Corporatisation framework is provided in Appendix A.

Government Business Sector Reform (1990s)

The commercialisation, and in fewer cases corporatisation, of government business represented the biggest micro-economic reform within the NSW public sector in its history. Three things in particular stood out:

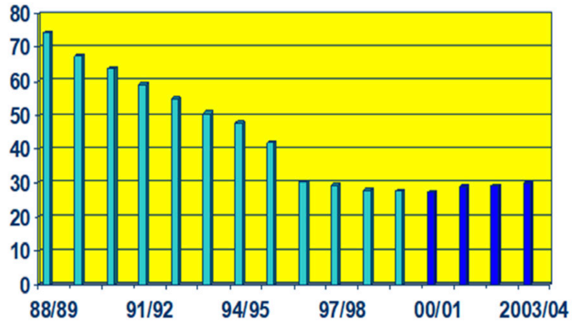
- A move from passive to active oversight of government businesses.
- A shift from loss-making to profit oriented government businesses.
- A change from monopolistic to more competitive or at least price regulated government businesses.

Previously, NSW governments left the monitoring of government businesses to their own boards of directors. Because such businesses served political rather than commercial goals, it was not clear what value their boards added.

The businesses either earned low profits or made large losses. Their overriding objective was job security, because trade unions exercised stronger influence than management. Dividend payments to the government as their owner were either non-existent or small.

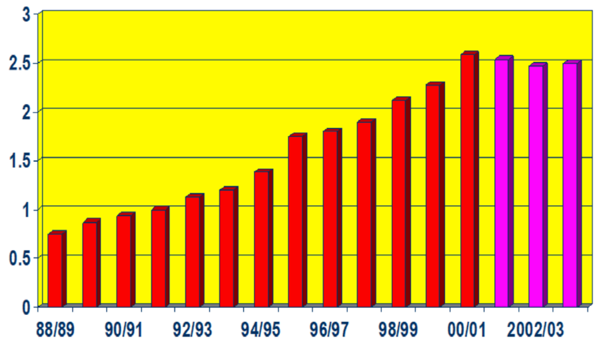
From 1990, government business' financial performance was monitored by a newly-created government businesses division within the NSW Treasury Department. Each business' performance was measured against targets negotiated in a

Figure 1: NSW Major Government Business Employment Levels ('000 employees)



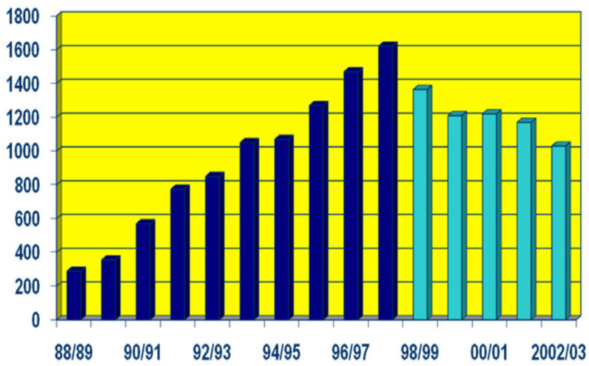
Source: NSW Treasury: *Performance of NSW Government Businesses*, back issues 1991-2004.

Figure 2: NSW Government Utilities' Labour Productivity Index (1991/92 = 100)



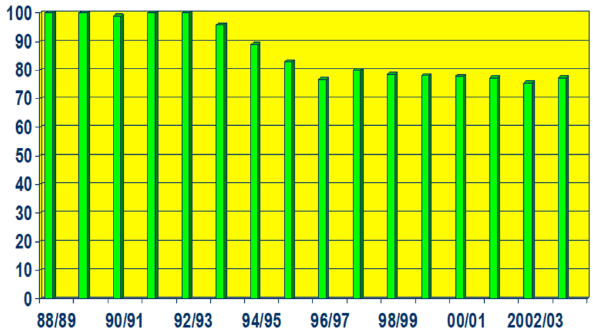
Source: NSW Treasury: *Performance of NSW Government Businesses*, back issues 1991-2004.

Figure 3: NSW Government Business Dividend and Tax Contributions ($million)



Source: NSW Treasury: *Performance of NSW Government Businesses*, back issues 1991-2003.

Figure 4: NSW Government Business' Real Prices Index (1988/89 = 100)



Source: NSW Treasury: *Performance of NSW Government Businesses*, back issues 1991-2003.

Statement of Corporate Intent. An annual publication, *Performance of NSW Government Businesses*, was launched by NSW Treasury in September 1990 to disclose their employment, output, productivity, pricing and financial results on a consistent basis at an enterprise, industry and aggregate level.

With the election of the Greiner government in 1988, government businesses had to attain a minimum return on assets and a viable capital structure (debt/equity ratio).They also had to meet an agreed dividend payout ratio.[5] The NSW Treasury, in concert with government business boards and their senior management, drove the program of commercialisation and corporatisation.

From 1988/89 to 2000/01, the NSW government business sector underwent a huge transformation. Most importantly, it marked the end of workplace featherbedding in utilities — enabling them to become successful enterprises that could make a commercial return on their capital assets while at the same time boosting their output, reducing their prices and trimming their debt. What follows is a summary of these dramatic results, illustrated by charts based on the published data from 1988/89 to 2003/04.

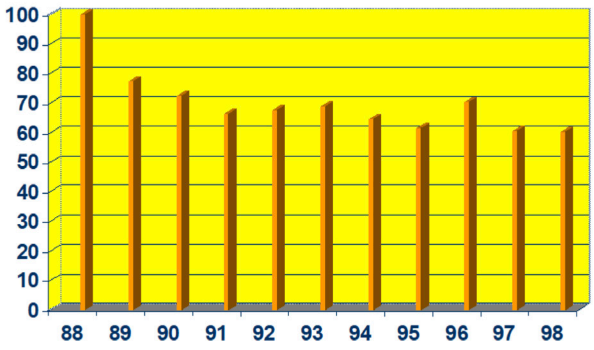
Total employment in major NSW government businesses more than halved from 74,300 to 27,400 over this 12-year period (see Figure 1), yet total output increased in real terms by almost a third — boosting workforce productivity by more than three-fold (see Figure 2).

This improved efficiency enabled total dividend and tax contributions to the Consolidated Fund (which subsidises the social programs of the general government sector, such as education and health) to increase more than five-fold, from under $300 million a year in 1988/89 to over $1,600 million a year by 1997/98 (see Figure 3).

The huge increase in dividend and tax equivalent payments to the government helped it weather lower tax revenues following a severe national economic recession in 1991/92. This assisted NSW to maintain its triple-A credit rating when all but one other state had a credit downgrade. That buoyed public confidence in the state's finances and economy.

Notwithstanding this huge transfer of resources from government commercial to social activities, government businesses still managed to reduce their

Figure 5: NSW Major Government Business' Real Net Debt Index (1987/88 = 100)



Source: NSW Treasury: *Performance of NSW Government Businesses*, back issues 1991-1998.

prices by over 20% (see Figure 4) and their net debt by around 40% (see Figure 5), both figures expressed in real terms.

Before these sweeping changes to the structure and governance of these businesses in 1988/89, they were not subject to normal taxes, were not permitted to retrench staff, had their debt guaranteed by the government for no fee and were sheltered from market competition yet allowed to set their own prices. They were also exempted from many industry regulatory requirements such as pollution control (e.g. Sydney Water's ocean sewage discharge).

After they were 'commercialised' or eventually 'corporatised', government businesses were subjected to 'tax' payments to the NSW Treasury — equivalent to what they would have had to pay the Australian Tax Office in income or other taxes if they were private enterprises. They were permitted to retrench surplus staff, required to pay a guarantee fee for their debt being underwritten by the state, exposed to market competition or price controls by the newly established IPART, and subjected to the same legal and regulatory compliance regime as private enterprises.

Government Business Sector Retreat (2000s)

An important take from the above charts (Figures 1 to 6) is that by the turn of the century, the performance gains waned; and in the case of dividend and tax contributions, they significantly fell after 1997/98. Data from other Treasury sources shows such contributions did not recover to their earlier heights until 2005/06. After 2003/04, the NSW Treasury ceased publishing data on the performance of NSW government businesses — possibly because micro-economic reform of the NSW government business sector largely ceased.

The reasons for this are not clear, but may be due to a combination of reform fatigue (with government ministers reasserting the primacy of politics over commercial goals in the way businesses were to be run) and the end of low-hanging fruit (i.e. once redundant jobs were scrapped further productivity gains through increased capital investment, technological innovation and business process re-engineering proved more incremental).

It's hard to read the minds of ministers at the time, but Carl Scully who was NSW Roads and Transport Minister between 1997 and 2003 made it clear in his autobiography that he saw government businesses as no different to departments when it came to operational control, viz:

> *Both Sims and Stack (Rod Sims Chair and Judi Stack, CEO of the NSW Rail, Access Corporation) rejected my decision to take charge of the track maintenance agenda, and appeared all but horrified, that I would want to interfere, in what they perceived to be the independent business of their semi-sovereign organisation. It was almost the reaction I would have expected from a private sector company board Chairman and its CEO, if I had tried to tell them both, how to run their company business. Except in this case, it was a government entity charged with operating an important part of the New South Wales Government Railway. The public rightly expects the relevant minister, as trustee of a public asset, to be in charge, and not subordinate personne*l. (Scully, 2017)

Business Case Studies (1988-2004)

The big picture results shown in the charts above disguise the outcomes at an individual enterprise level. Hence it's worth examining a random sample of these government businesses between 1988/89 (when the initial commercialisation/corporatisation drive started) and 2000/01 (when the massive labour productivity gains peaked, slipping thereafter). This 12-year period could be labelled the 'Golden Era' of micro-economic reform for NSW government businesses.

Examining progress at an enterprise level is complicated by the fact that government businesses were restructured over this period. For instance, the NSW Electricity Commission was split into 11 separate generating, transmission and distribution businesses; and the State Rail Authority was divided into distinct passenger, freight, network ownership and infrastructure businesses. Also, the first NSW Treasury *Performance of NSW Government Businesses* annual overview publication in September 1990 covered only major government businesses — though subsequent editions extended to smaller ones. Hence, it is not possible to trace the results of each business entity over this entire period; though data is available at an industry sector level for electricity, water and transport.

Delta Electricity operated four coal-fired power stations near Lithgow and on the Central Coast. It also operated two mini-hydro generators and bio-mass co-firing activities. Between March 1996 (when it became a self-standing entity) and June 2001, its annual output rose from 16,917 to 21,163 GWh while its workforce fell from 1,248 to 782. In other words, its GWh per employee doubled from 13.6 to 27.1. This enabled it to lift its dividends to the state government from nil in 1995/96 to $96.7 million in 2000/01. Over the same period, its corporate tax equivalent payments to the state increased from $2.6 million to $17.2 million. Its gross external debt was also reduced marginally over this five-year period.

Hunter Water is the water and wastewater service provider to the Lower Hunter region; including Maitland, Cessnock, Port Stephens, Lake Macquarie and Newcastle. It served almost half a million people occupying 190,000 properties. Between 1988/89 and 2000/01, the total volume of water supplied went from 78,100 to 76,500 megalitres, while the number of employees involved in providing this fell from 1,280 to 533. This meant the average output per worker jumped 135% over this period — which allowed the average operating cost per property served to fall from $418 to $288. And the real price index for water dropped from 93.0 to 63.3, while dividend and payments to the state jumped from $2.3 million to $30.0m.

Freight Corp was carved out of the State Rail Authority in January 1989. It transported bulk commodities and general freight, and also provided supporting logistical services to its customers throughout Australia beyond its rail line haul route. Between 1990/91 and 2000/01, it reduced its total employment from 12,471 to 2,133, lifting its output per employee from 1,140,000 to 6,621,000 net tonne kilometres carried per locomotive — though this figure became exaggerated by more than 3,000 infrastructure and train control staff being transferred to other rail entities in July 1996. Excluding this shift, output per employee increased from about 1,509,000 to 6,621,000 net tonne kilometres carried per locomotive. However, on-time running deteriorated from 79.1% to 69.6%.

State Rail Authority was reconstituted in July 1996 to provide passenger rail services through two business groups, City-Rail (covering metropolitan Sydney, Newcastle and Wollongong and surrounding regions) and Country-Link (covering rural towns and regional cities in the rest of the state). It also operated 34 Travel Centres and eight Booking Offices across the network to sell tickets and promote tours. Its total employment decreased from 9,344 in 1996/97 to 9,017 in 2000/01, and its passenger journeys per employee rose from 29,000 to 33,000. On-time running increased slightly on suburban and intercity trains, but fell significantly on country trains.

Prior to divesting the Rail Access Corporation (which took ownership of the rail infrastructure network) and Rail Services Authority (which took responsibility for rail construction and maintenance) in July 1996, the State Rail Authority's employment fell from 26,602 in 1990/91 to 9,344 in 1996/97, resulting in its passenger journeys per employee over this period jumping from 9,200 to 29,000; a massive increase in productivity. At the same time, total hours lost due to industrial disputes plummeted from 24,600 to zero, and on-time running improved significantly across suburban, intercity and country stations.

Sydney Ports Corporation was established in 1995, and owned and managed the commercial ports of Sydney Harbour (Glebe Island/White Bay, Darling Harbour and Sydney Cove Passenger Terminal) and Botany Bay (container terminals and bulk liquids facilities). Its total employment fell from 231 in 1995/96 to 196 in 2000/01. Over this period, its total trade increased from 31.6 to 43.9 million tonnes meaning its volume per employee jumped 63.7%. But over the same time, its operating result fell because trade was down in 2000/01 due to a world-wide economic slowdown and loss of trade to other ports due to the Sydney Olympics.

Government Business Sector Relinquishment (2010s)

Privatisation of government businesses can take various forms:

- Divestment: sale or leasing of public enterprises to the private sector;
- Withdrawal: vacating a space for the private sector to move in;
- Outsourcing: private provision of services previously delivered by public sector agencies;
- Liberalisation: relaxation of public monopolies to create contestable markets open to private sector service providers; and
- User pays: the substitution of private funds (i.e. fees) for public funds (i.e. taxes) to reduce the public subsidy.

Though the Carr and post-Carr Labor governments (1996-2011) privatised PowerCoal, Energy Australia's retail arm and Country Energy, it was not until after the election of the O'Farrell Coalition government in 2011 that the NSW electricity sector was almost completely privatised. The Carr government attempted to do so in 2007, but was blocked by the NSW ALP's Annual Conference.

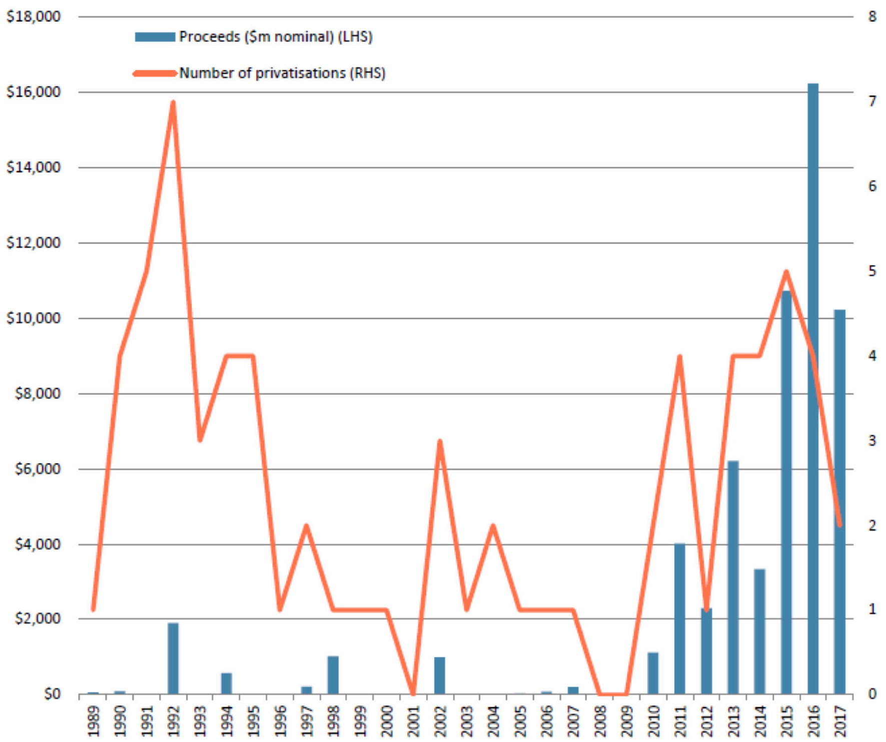
The Greiner and Fahey Coalition governments (1988-1996) privatised financial institutions (GIO and State Bank) and the Carr and post-Carr Labor governments (1996-2011) privatised gambling (TAB and Lotteries) and rail freight. The privatisation of ferry operations, desalination, ports, and titling and registry occurred after the election of the O'Farrell Coalition government in 2011. Baird succeeded O'Farrell as Premier in 2014 and Berejiklian succeeded Baird in 2017.

NSW Government Businesses Privatised

- Government Brickworks
- Government Abattoirs
- Government Printing Office
- Government Insurance Office
- State Bank of NSW
- Axion Funds Management
- TAB Ltd
- Grain Corp
- Freight Corp
- Powercoal
- NSW Investment Corp
- Junee & Parklea Prisons
- NSW Lotteries
- Waste Recycling & Processing
- Electricity (Generation, Transmission, Distribution and Retail)
- Sydney Ferry Operations
- Sydney Desalination Plant
- Botany, Kembla and Newcastle Ports
- Titling & Registry (LPI)

Source: Selectively compiled from NSW Parliamentary Research Service (2017).

The next chart shows the number of privatisation projects each year between 1989 and 2017, and their annual gross sales proceeds. The striking feature is how first the number, and later both the number and proceeds, of asset sales swelled during the Coalition governments of 1988-96 and 2011-2017. Nevertheless, several privatisations still occurred during the Labor governments of 1996-2011, as outlined earlier.



Source: NSW Parliamentary Research Service (2017).

NSW government businesses that may be future candidates for privatisation are listed in the next chart.

NSW Government Businesses that could be privatised in future include (totalling $60b):

WestConnex stake (49%)

Ausgrid stake (49%)

Endeavour Energy (49%)

Essential Energy

Sydney and Hunter Water

NSW Lotteries revenue

Motor registries

Northern Beaches Link/Western Harbour Tunnel

F6 Extension (Stage 1)

Source: Ludlow and others (2019)

Reasons for undertaking privatisations vary, but include such things as a desire to:

- Raise funds for investing in pressing social and economic infrastructure (e.g. hospitals, schools, roads, railways, etc.) or repay debt;
- Improve productive efficiency where poor management systems and restrictive work practices exist; and
- Attract private investment and innovation in an industry that needs recapitalisation.

A relevant example is Sydney Ferries, where one analyst justified privatisation as follows:

> *To provide a quality service at the lowest possible cost, government needs to open up the Sydney ferry market to competition.*
>
> *Two private ferry operators run completely unsubsidised services on the Manly route in competition with the government's ferry service. The price of a regular adult ticket stands at between $8 and $9.*
>
> *Contrast this to the government's service which, after accounting for subsidy (to the tune of 50%–60%), costs as much as $14.*
>
> *Without the pressure of losing business, Sydney Ferries lacks sufficient incentive to reduce costs and maintain quality service. This is why ferry reform must introduce competition*. (Philipatos, 2011).

Privatisation gained wider public acceptance following the election of the O'Farrell Coalition government in 2011. As one observer noted:

> *There is a growing resignation within the community that privatisation may now be inevitable if governments are to fund improved infrastructure or pay down debt.*
>
> *The community is prepared to concede ground on assets in markets which are contestable and where there is no sentimental ownership issue.*
>
> *The key is to show how and where the money will be spent and the term "'recycling capital" has become the alluring catchphrase.*
>
> *Our research shows the more specific the projects identified the stronger the support*. (Tyson, 2013).

Nevertheless mistakes were made, especially when it came to ensuring free markets.

Rod Sims, Chairman of the Australian Competition and Consumer Commission, was reported as saying that:

> *"…he has become so exasperated by the way in which governments are privatising public assets that they need an "uppercut".*
>
> *"He says governments have repeatedly botched the sale of airports, electricity infrastructure and major ports – making things worse for consumers – because, when selling the assets, they have been motivated by maximising profits rather than making efficiency gains.*
>
> *"He says governments have created private monopolies without sufficient regulation to stop those monopolies overcharging users – and the public knows it and has a right to be angry."* (Hutchens, 2016)

One of Sims' examples was the privatisation of the Newcastle Port, which he said subsequently revalued its assets to justify huge increases in port charges (Hutchens, 2016).

Newcastle Port later complained that it was prevented from competing with Port Botany and Port Kembla on general freight so that the NSW Government could maximise proceeds from selling these ports (McGowan, 2017). The ACCC subsequently instituted proceedings in the Federal Court against the owners of Port Botany and Port Kembla for entering agreements with the NSW Government that it alleged constricted competition and were illegal (ACCC, 2017).

The obvious way to avoid market rigging in future is for governments to agree to the ACCC vetting and approving all privatisation proposals before they are finalised.

Asset Recycling

The term 'asset recycling' (coined by the then NSW Treasurer and later Premier, Mike Baird) displaced the word 'privatisation' in public statements. It also more accurately reflected what was happening, since assets were generally leased on long term contracts rather than permanently sold. Also, their sales proceeds were reinvested in new assets serving a public purpose, rather than spent on recurrent government services that had no lasting benefit once consumed.

The concept of 'recycling' public assets, rather than diminishing them, not only assuaged public opinion in NSW but attracted interest nationwide and in other countries — especially the USA, where governments were keen to explore new ways of funding capital works (Nowacki, Monk & Levitt, 2017). The Australian federal government went so far as introducing a $5 billion Asset Recycling Initiative (ARI) for participating states and territories (Deloitte, 2014)

Sales proceeds from privatising government businesses (or 'asset recycling' as the government preferred to call it), together with massive borrowing, enabled almost a quadrupling of average annual infrastructure spend in the general government sector from $5.4 billion in the post-Carr Labor government to $19.0 billion under the current Coalition government. See table below.

The heavy annual borrowing planned for 2018/19–2021/22 follows a reversal from net debt of $8 billion in mid-2011 to the government having not only paid off its debt, but having a cash reserve of $11.2 billion by mid-2018 (NSW Treasury, 2018b).

NSW General Government Sector Average Annual Operating Balance, Net Borrowings and Infrastructure Investment of Four Eras of Government from 1996/97 to 2021/22

General Government (excluding Government Businesses)	Period	Operating Balance $ Billion	Net Borrowing $ Billion	Infrastructure Investing $ Billion	Key Fiscal Attributes
Carr Labor	1996/97 – 2004/05	+1.3	(0.1)	3.0	Strong surplus Net lending Modest infrastructure
Post-Carr Labor	2005/06 – 2010/11	0	2.6	5.4	Balanced budget Modest borrowing Strong infrastructure
Coalition (past)	2011/12 – 2017/18	+2.3	1.2	9.1	Strong surplus Low borrowing Huge infrastructure
Coalition (future)	2018/19 – 2021/22	+ 1.1	11.5	19.0	Strong surplus Massive borrowing Massive infrastructure

Source: Pre-2018/19 Data: NSW Budget Statement June 2018: Page A1-14, Post 2018/19 Data: NSW Parliamentary Budget Office Impact Statement for Coalition, 18.3.2019

Conclusions

Five important lessons can be drawn from NSW's effort to rejuvenate its government businesses post-1988.

The first is that government businesses need to operate like private enterprises if they are to generate a commercial rate of return. Otherwise, their dividend and tax contributions to funding general government services — such as health, education and police — will stagnate or fall, as they did after 1997/98.

The second is that if government businesses are required to provide social benefits (e.g. pensioner concessions), they should be compensated from the government's own budget, so that their commercial charter and culture are not compromised. Governments can perform social and commercial roles, but if it mixes the two it creates conflicting objectives that undermine each sector's *raison d'etre* and corrupt its modus operandi.

Thirdly, all government businesses should be genuinely 'commercialised' and 'corporatised' so as to maximise their productive efficiency. That would help to contain their prices and debt while boosting their dividend and tax equivalent payments to their owner, the government — as happened during the reform years of the 1990s.

Fourthly, it's difficult to operate commercial businesses in the public sector because it is driven by politics, not markets. In other words, citizen votes count more to politicians than do consumer dollars. That appears to have happened in the 2000s. This is one reason governments privatise their own businesses — because they find it too hard to run them commercially instead of politically.

Finally, all government business divestments should be subject to ACCC scrutiny and approval, to ensure they don't result in market distortions that disadvantage consumers.

These conclusions square with a famous public policy text that recommended the public sector should focus on *"steering rather than rowing"* (Osborne & Gaebler, 1992).

In other words, government is best suited to making public policy and regulations, redistributing income and subsidising worthy causes with a view to achieving a safe and fair society; while competing private firms do best at selling goods and services to consumers to ensure economic prosperity. A mixed economy should not mean the government and private sectors replicating each other's roles, but each sector doing what it does best — and thereby complementing the other's strengths.

These lessons remain relevant today because while there are fewer government trading enterprises than before, politicians are still bent on overturning their commercial imperative. Witness the recent Ministerial orders in NSW stopping Essential Energy lifting its productivity by shedding 180 jobs in regional NSW (Smith, 2019). These cost savings could have boosted dividend payments to the government — which it could use to hire more teachers and nurses in rural towns. This reinforces the case for privatising remaining government businesses so they can behave as businesses, not job refuges. Simply corporatising them is not enough.

Appendix

The Corporatisation Policy Framework embraced by the Greiner government in late 1988 (Sturgess, 1988 and Allan, 1992) consisted of five principles that guided the subsequent regulation and operation of government businesses in NSW, and shaped the approach to government trading enterprises adopted nationally (Special Premiers' Conference, 1991).

The first principle of clear and non-conflicting objectives required a government business to:

- Have separate commercial, social and regulatory functions.
- Have profit maximisation as its prime objective.
- Have explicit contracts with the government for any community service obligations (CSOs)
- Transfer any regulatory functions to separate Ministerial organisations (e.g. Sydney Water divested its regulatory role to the NSW Environment Protection Authority (EPA).
- Have a shareholding Minister (the Treasurer) separate from its Portfolio (regulatory and/or CSO) Minister.

The second principle of managerial responsibility, authority and autonomy required that:

- Shareholding Minister appoint the business' board and define the enterprise's role.
- Board directors should be appointed for their business management experience, knowledge and acumen.

- Board and management should make the major decisions affecting performance of the enterprise.
- Government should limit its directions to the business to its capital structure (debt/equity ratio), profit target (rate of return on assets) and pay-out policy (dividend to profit ratio).

The third principle of independent performance monitoring meant that:

- The business' board and management should be held personally accountable for the performance of the enterprise.
- A business analyses unit (within Treasury) should independently and objectively monitor the business' performance on behalf of the shareholding minister (the Treasurer).
- The Treasury unit's monitoring should focus on the commercial performance of the enterprise against quantifiable targets.
- Performance targets should be defined in Statement of Corporate Intent agreed between the enterprise and the shareholder.

The fourth principle of rewarding good performance and penalising bad performance meant:

- Pre-defining rewards and sanctions against agreed and explicit performance targets.
- Ensuring rewards and sanctions were strongly applied and not fudged.
- Offering a reward structure that encompassed salary, non-cash rewards, bonus schemes and profit sharing arrangements.
- Imposing sanctions that included tougher reporting rules, redefining the core business permitted, removing discretion over investment and borrowings, cutting remuneration and ultimately retrenchment.

The fifth principle of introducing competitive neutrality in all markets required removing the competitive advantages or disadvantages arising from government ownership. Of course competition, as with the private sector, could range from perfectly competitive (e.g. Sydney car rentals) to restricted competition (e.g. Sydney taxis before the advent and legalisation of Uber) and contestable (e.g. Sydney Ferries after they were tendered to private operators).

The competition guidelines applied to input, output and natural monopoly markets.

Competitive neutrality in output markets required:

- Removal of all protective barriers and exposure of PTEs to competition.
- Applying same regulatory requirements (e.g. the Trade Practice Act) as exist for private enterprises.

In input markets competitive neutrality meant:

- Levying a fee on all debt to remove any interest rate advantage stemming from government ownership. Alternatively, a central borrowing authority (e.g. T-Corp) charge PTEs full commercial rates.
- Return on government equity in a PTE should equate with that which could be obtained from a private company with similar investment risk.
- Removal of any restrictions on labour (i.e. award pay and conditions) that do not apply to private enterprises.
- Imposing the same national, state and local government taxes[6] as apply to privately owned companies. Since state PTEs are exempted from national taxes require them instead to pay equivalent amounts to the state.

Certain PTEs enjoy a natural monopoly market (e.g. water and electricity distribution) while others enjoy a contrived restricted franchise (e.g. water storage and retailing). The removal of legislative barriers to competition won't alter natural monopolies. A regulatory framework is required to prevent abuse of monopoly powers (e.g. IPART price controls). PTEs should be unbundled into competitive and natural monopoly components (e.g. electricity generation and retail versus transmission and distribution), with each run as a separate and independent business.

References

- Allan, P. (1992). *A Guide to the Theory and Practice of Commercialisation and Corporatisation in NSW*, NSW Treasury, Sydney.
- Aulich, C. (2005). "Privatisation and Outsourcing", in Aulich, C. & Wettenhall, R. (Eds), *Howard's Second and Third Governments: Australian Commonwealth Administration 1998-2004*, Sydney: UNSW Press.
- Aulich, C. & O'Flynn, J. (2007). From Public to Private: The Australian Experience of Privatisation, *The Asia Pacific Journal of Public Administration, 29 (2),* 153-171.
- ACCC (2018), Australian Competition and Consumer Commission, *ACCC takes action against NSW Ports,* 10th December 2019. Retrieved from https://www.accc.gov.au/media-release/accc-takes-action-against-nsw-ports
- BHP Billiton Group, *Financial Information for the year ended 2010*, 25th August 2010, page 21. Retrieved from https://www.bhp.com//media/bhp/documents/investors/news/2010/100825bhpbillitonresultsyearended30june2010.pdf?la=en
- Collier, B. and Pitkin, S. (2001). *Corporatisation and Privatisation in Australia*, CCH Australia Ltd, Sydney.
- Deloitte. (2014). *Government Asset Recycling, Making more achievable, Greater bang for funding buck*. Retrieved from https://www2.deloitte.com/content/dam/Deloitte/au/Documents/finance/deloitte-au-fas-govt-asset-recyling-030215.pdf
- Humphry, R (1997), *Review of GBE Governance Arrangements*, Commonwealth of Australia, Canberra.
- Hutchens, G (2016), *ACCCs Rod Sims says privatisation 'seriously damaging' the economy*, The Guardian, 27th July 2016. Retrieved from https://www.theguardian.com/australia-news/2016/jul/27/acccs-rod-sims-says-privatisations-severely-damaging-economy
- Ludlow, M (2019), *States urged to sell $220b in public assets rather than increase debt*, Australian Financial Review, 20th June 2019. Retrieved from (https://www.afr.com/business/infrastructure/states-urged-to-sell-220b-in-public-assets-rather-than-increase-debt-20190619-p51z9o)
- McGowan, M (2017), Newcastle wants to reduce reliance on coal – but that's easier said than done, The Guardian, 19th December 2017. Retrieved from https://www.theguardian.com/australia-news/2017/dec/19/port-of-newcastle-chairmans-comments-on-coal-are-basically-a-call-for-help
- Nowacki, C., Ashby Monk, A., & and Levitt, R. (2017) How America can copy Australia's asset-recycling scheme, *The Conversation*, June 6, 2017. Retrieved from http://theconversation.com/how-america-can-copy-australias-asset-recycling-scheme-78471
- NSW Parliamentary Research Service. (2017). Privatisation in NSW: a timeline and key sources, *Issues Backgrounder, 2*. Sydney. Retrieved from https://www.parliament.nsw.gov.au/researchpapers/Documents/Privatisation%20in%20NSW%20-%20a%20timeline%20and%20key%20sources.pdf
- NSW Treasury (1990-2002), Treasury Policy Papers (TPPs) on various aspects of government businesses including performance reporting and monitoring, financial distribution, capital structure, government guarantee fee, governing boards, community service obligations and tax equivalent regime, back issues, back issues 1990-2002.
- NSW Treasury (1991-2004*), Performance of NSW Government Businesses*, back issues 1991-2004.
- NSW Treasury (2003-2010), *Commercial Policy Framework*, back issues 2003-2010.
- NSW Treasury (2010), *New South Wales Report on State Finances*, 2009-10.
- NSW Treasury (2018a). Commercial Policy Framework: Performance Reporting and Monitoring Policy for Government Businesses, *Policy and Guidelines Paper, TPP18.02*, page 2.
- NSW Treasury (2018b), *Report on State Finances 2017/18*, pages 4-10 and 4-13.
- Osborne, D. & Gaebler, T. (1992). *Reinventing Government*, Adison-Wesley, Reading (MA).
- Philipatos, A. (2011). *Free-Trade Ferries: A Case for Competition*, The Centre for Independent Studies, St Leonards, N.S.W.
- Reark Research Pty Ltd (1993), *Project Profile – Public Attitude towards the State Budget*, August 1993, pages 8-9.
- Scully, C. (2017). *Setting the Record Straight, A Political Memoir*, Sydney, Self-Published.
- Smith, A (2019), *Berejiklian drawn into a bitter debate that was not of her making,* Sydney Morning Herald, 21st August 2019. Retrieved from https://www.smh.com.au/politics/nsw/berejiklian-drawn-into-a-bitter-debate-that-was-not-of-her-making-20190820-p52j27.html

- Special Premiers' Conference, (1991), Task Force on Monitoring Performance of Government Trading Enterprises, *Characteristics of a Fully Corporatised GTE*, Discussion Paper No.1, and *Checklist for National Stocktake of GTE Reforms, Discussion Paper No.2*, Canberra, July 1991, Reproduced by NSW Treasury, August 1991.
- State Owned Corporations Act (1989), NSW Legislation.
- Sturgess, G (1988), *A Policy Framework for Improving the Performance of Government Trading Enterprises,* A Report by the Steering Committee on Government Trading Enterprises chaired by Gary Sturgess, 15th Sept 1988.
- Tyson, B. (2013). Co-Founder, GA Research, a market and social research firm, *Australian Financial Review*, 2nd May 2013.
- Walker, B. & Con Walker, B. (2000). *Privatisation: Sell Off or Sell Out? The Australian Experience*, ABC Books, Sydney.

Endnotes

1 Public transport and housing are important exceptions since they rely heavily on direct subsidies from the government's annual operating budget.

2 Currently NSW government businesses include government entities within the general government sector that have a commercial charter and recover a significant share of their expenses from the sale of goods and services as well as state owned companied registered under the Commonwealth Corporations Act 2001 where the NSW Treasurer is a shareholder (NSW Treasury, 2018a).

3 A NSW Government central agency inquiry (conducted by the heads of Cabinet Office (Gary Sturgess, Chair), Premiers Department (Richard Humphry) and Treasury (Percy Allan) assisted by a New Zealand investment bank Fay, Richwhite & Company, prepared a report in September 1988 (Sturgess 1988) on the principles for guiding the "commercialisation" and "corporatisation" of NSW government trading enterprises based on the New Zealand experience. This was the first report of this kind in Australia and set the broad framework for later reports such as NSW Treasury (1990-2002), Special Premiers Conference (1991), Allan (1992), Humphrey (1997) and NSW Treasury (2003-2010).

4 For instance the Howard Government in 1997 commissioned Richard Humphry, former Director General of the NSW Premiers Department, to undertake a review of Commonwealth government businesses which recommended governance rules similar to those in NSW. See Humphry (1997).

5 A survey of public attitudes towards the state budget was commissioned of Reark Research Pty Ltd by the incoming NSW Treasurer in August 1993. It found that *"Financial management is seen as an extremely important, even the most important, role of State Government"* and *"There was a consistent theme of requiring value for money from the administrators and bureaucrats… People talked about the need for productivity, a concept they were familiar with in their own workplace."* Reference: Reark Research (1993).

6 Water and sewerage services are exempted in Australia from a goods and services tax (GST).

Percy Allan is a former Secretary of the NSW Treasury (1985 – 1994) and played a key role in helping to introduce, champion and roll out the Commercialisation and Corporatisation Framework for all NSW government trading enterprises in the late 1980s and early 1990s.

About the Author

Percy Allan AM

Percy Allan is a public policy, management and finance adviser and a former Secretary of the NSW Treasury (1985-1994) and Chair of the NSW Premier's Council on the Cost and Quality of Government (1999-2007).

Related works

John Humphreys, Budget 2019: *Why the long-term tax cuts should be fast-tracked*, CIS Policy Paper 19 (4 April 2019)

Robert Carling and Terrence O'Brien, *Voting for a living: A shift in Australian politics from selling policies to buying votes?,* CIS Policy Paper 9 (5 September 2018)

THE CENTRE FOR INDEPENDENT STUDIES

POLICY Paper 23 (PP23) • ISSN: 2209-2447 • ISBN: 978-1-925744-48-4

Published September 2019 by the Centre for Independent Studies Limited. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers.

This publication is available from the Centre for Independent Studies. Visit **www.cis.org.au**.

Level 1, 131 Macquarie St, Sydney NSW 2000 • **phone:** +61 2 9438 4377 • **email:** cis@cis.org.au