

**SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE**

Energy Sector Reform Bill

FEBRUARY 1992

ENERGY SECTOR REFORM BILL

1.0 Introduction

- 1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies which reflect overall New Zealand interests.
- 1.2 The Business Roundtable is interested in encouraging the adoption of policies which maximise the efficiency of the electricity industry. It has participated in previous reviews of the industry, presenting a major submission on pricing issues to the government in 1985, and it has supported the formation of the Electricity Corporation as a state-owned enterprise (SOE) and the deregulation of the generation market. It is satisfied that the steps so far taken have been highly successful in improving the performance of the industry.
- 1.3 Electricity is a major industry and the efficiency with which it uses resources affects the welfare of all New Zealand businesses and households. For the purposes of policy there is little that is different about electricity compared with competing energy forms such as gas, coal or petroleum, or that distinguishes it from other utilities such as telecommunications. All these industries are now in private ownership in New Zealand and operate in largely deregulated markets. They are now performing far more satisfactorily than when they were subject to government ownership and/or heavy regulation.
- 1.4 This submission supports the government's further moves to deregulate the electricity distribution sector and to corporatise and possibly privatise electrical supply authorities (ESAs). This sector has been lagging behind in the reform process. However, in our view, the government should take these reforms through to their logical conclusion of full privatisation of ESAs and deregulation of the markets in which they operate. These issues are discussed in more detail in this submission. The submission does not address other important issues relating to the electricity reform process or the proposed changes to the gas sector. Important decisions remain to be taken on transmission and generation, but we see the current investigation of a separate ownership structure for Transpower, the development of a wholesale market and a power pool, and the case for any break-up of generation as constituting a logical decision path which presents no obstacles to decisions at this stage on the distribution sector.

2.0 The Case for Corporatisation and Privatisation

- 2.1 We broadly support Section III of the Energy Sector Reform Bill in which the government proposes the formation of electricity companies from ESAs. The proposed reforms are based on the approach adopted for SOEs under the State-Owned Enterprises Act 1986.
- 2.2 The SOE reform process, which has involved the deregulation of the operating environment of state-owned organisations and the establishment of commercial objectives and structures, has improved the performance of a wide range of SOEs. Many have gone from loss to profitability; output per employee has

increased substantially; production costs have decreased; and the organisations are now more responsive to the needs of their customers.

- 2.3 Treasury estimates that shareholder wealth in the original 14 SOEs increased by \$1.7 billion in their first three years. The success of the corporatisation programme is illustrated by a number of different businesses. CoalCorp, in its first full year of operation, turned a loss of \$23 million into a small profit without increasing its prices. New Zealand Post transformed a loss of \$38 million in 1986/87 into a profit of \$53 million in 1989/90 without increasing the price for basic mail and at the same time improved service delivery by 5 to 10 percent despite an increase in the volume of mail delivered. Telecom reduced staff from around 25,600 in 1987 to approximately 17,000 in 1990, lowering costs in many areas by using sub-contractors for services previously provided within the company. Service standards improved substantially; for example the average time for telephone connections has been reduced from six weeks to two working days. In 1991 prices for toll calls fell dramatically in response to competition. The Electricity Corporation has reduced its unit operating costs in real terms by a total of 28 percent and increased its productivity (measured in terms of GWh per employee) by 71 percent over the four years to March 1991. New Zealand's ports, which have been exposed to a similar corporatisation process, achieved a first year saving from port reform estimated by the Ministry of Transport at \$58 million. It is no longer plausible to argue, as many did, that the former organisations were not wasteful and inefficient and not in need of reform. It is also clear that further improvements in performance have been made by SOEs that have been privatised.
- 2.4 The overall success of the SOE reform programme lends strong support to the government's proposals to increase the commercial focus of ESAs and to enhance the accountability of managers through corporatising ESAs. This will reinforce gains that have been achieved since the appointment of more commercial boards in 1990. In our view and in the light of the success of the SOE process, we believe that those opposing reform should bear the burden of proving that the SOE/privatisation model is not applicable to ESAs.
- 2.5 Nevertheless, we are concerned about some important details of the corporatisation process proposed for electric power boards (EPBs) and, in particular, the role of the Electric Power Trusts (Trusts) which will hold the shares in the companies created from EPBs on behalf of consumers. The concerns include the suitability of elected individuals representing the ultimate owners (particularly when, by assigning shares to consumers, the ultimate owners could be directly represented); the difficulty of ensuring accountability of the trustees to ultimate owners; and the vagueness of the role of the Trusts.
- The initial trustees will be those appointed by the government - EPB members that were elected in the elections of 1986. Subsequent trustees will be chosen in three yearly elections. It is doubtful whether individuals that are successful in a political process will have the commercial skills necessary to undertake the role proposed for Trusts. In particular, the task of selecting directors, monitoring the performance of the managers and directors of the distribution companies, and possibly managing the process of privatisation all require high levels of commercial skill. In our view

individuals with these attributes are unlikely to be selected through a political process.

- The trustees are expected to act on behalf of the consumers who are assumed to be the ultimate owners of the distribution companies. However, the mechanisms for ensuring accountability to owners are limited to the proposed three yearly elections and the ability of consumers to request a poll of preferred ownership options. The lack of interest in EPB elections in the past, and the inability of individuals to gain substantially from monitoring trustee or company performance, underlines the likely ineffectiveness of the first of the mechanisms. The latter constraint may be important although it will be attenuated by the cost and difficulty of organising a poll of consumers.
- A third problem is the lack of guidelines for the use of dividends or the proceeds of share sales which will be received by Trusts. The purposes and beneficiaries of the Trusts are not defined in the Act, and it is not clear whether the Trusts are to be created for a purpose (generally charitable purposes only) or for particular beneficiaries. Since distributions will be decided by the Trusts, the prospect of applying funds to projects favoured by particular interest groups or to particular classes of customers will provide strong incentives for such groups to capture control of Trusts through the electoral process (in the face of general elector apathy). To protect against this possibility the government could more clearly specify the objective of the Trusts and require that dividends be paid out to electricity consumers.

2.6 However, the difficulties with the concept and likely operation of the Trusts, and other arguments discussed in more detail below for moving immediately to privatisation, lead us to conclude that it would be undesirable for the government to vest ownership of the distribution companies in the Trusts. Privatisation would eliminate any justification for the establishment of Trusts and do away with an unsatisfactory structure and a costly electoral process.

2.7 Despite the major advances achieved by corporatisation and our general support for the reforms proposed by the government, we note that the SOE approach cannot replicate some important constraints that apply to private sector organisations, particularly those that arise from the transferability of ownership and the development of trading in shares. The normal capital market pressures that occur through traded equity, the contestability of management control and the risk of bankruptcy are severely limited in SOEs. Competitive neutrality cannot be achieved as long as government debt carries an implicit guarantee. Efficiency-reducing political interventions are much more likely when public ownership is retained. It has proved impossible to develop effective monitoring regimes that compare adequately with private sector monitoring mechanisms. Top performance cannot be achieved simply by appointing commercially experienced directors to boards. On the contrary, it is the environment created by competition in the markets for goods and services, capital and corporate control that encourages the selection of capable directors, competent performance on their part or replacement in the event of non-performance.

- 2.8 We also note some disturbing trends in New Zealand which reinforce our concern that corporatisation may not be sustainable over time and that privatisation is necessary to cement into place the gains achieved by corporatisation. For example, some recent appointments to SOE boards appear to have been political in nature rather than made on the basis of commercial expertise. Interest groups and politicians have pressured SOEs to make decisions on political rather than commercial grounds. Concern has been expressed over the quality of monitoring of local government-owned trading companies.
- 2.9 These problems suggest that privatisation is the logical end point of the corporatisation process and that without privatisation the benefits of corporatisation may be short-lived. This observation is reinforced by the worldwide moves away from state-controlled industries to privatisation. Electricity industries in OECD countries have predominantly been in private hands for a long time but privatisation of those remaining in government ownership is now a general phenomenon. Literally dozens of countries or states are now engaged in electricity sector privatisation.
- 2.10 For these reasons we support the government's aim of facilitating privatisation but believe that the proposed process imposes unnecessary and costly barriers to achieving this end point. Of particular concern is the role of Trusts; the requirement that a decision on privatisation be decided by a poll of consumers; and the suggested limit on individual shareholdings of 15 percent.
- 2.11 We have noted above our concerns about the incentive and accountability problems that exist with the establishment of Trusts to act on behalf of consumers. These concerns include the potential for a conflict between the wishes of consumers to own and dispose of their own shares and trustees who may be reluctant to give up the power that their position gives them. We believe that Trusts, once established, may become powerful opponents of further reform and, in particular, of privatisation. The process of getting port company privatisation underway has been laborious and a source of frustration to recent governments, even though the shareholdings are in the hands of territorial authorities and were in the nature of a windfall gain to them. With electricity shares being held by a special-purpose authority which would go out of existence following privatisation, the process would be likely to be even more difficult.
- 2.12 The Bill allows privatisation to be determined through a poll of consumers. However, because privatisation is the logical end point of the reform process, in our view the requirement for a poll of consumers is unnecessary. Instead it imposes a costly process that will delay the realisation of the major benefits of privatisation.
- 2.13 Privatisation could be achieved through a number of mechanisms. We discuss two main options: a giveaway of shares to customers; and a negotiated sale to the highest bidder(s) with a distribution of proceeds to an appropriate tier of government or to consumers. The criteria for choosing between different processes include the following: the process should be fair and efficient, facilitating the transfer of shares to those investors that value them most highly;

it should be as simple as possible; and possible impediments to sale should be minimised. Normally, maximisation of the proceeds of sale would be an important objective but uncertainty over the ultimate ownership of EPBs reduces its importance in the current context.

- 2.14 The first option is to allocate shares to consumers. Although consumers do not have clear ownership rights in EPBs, they have effectively borne many of the risks of the operation of EPBs through their exposure to cost-plus pricing. As a result, their claim to ownership is greater than ratepayers', who were nominally required to underwrite the financial performance of EPBs. Because consumers do not have a formal legal entitlement to ownership in the EPBs, the allocation of shares can be based on simple practical considerations rather than by strictly determining and meeting legal rights. Shares could, for example, be allocated to consumers that hold an account at a particular date with a minimum amount allocated per consumer and additional shares allocated on the basis of consumption. A number of alternative bases for share allocation could be considered. The preferred option should be one for individual EPBs to decide, within general guidelines. Consumers could then decide the future ownership of the organisation through their decisions to retain or dispose of the shares.
- 2.15 An alternative privatisation mechanism would involve selling the organisation through a negotiated sales process to the highest bidder (this could be accompanied by a requirement for a partial float of shares as with Telecom and Air New Zealand if the government considered this to be desirable). This would help ensure that the assets went to the shareholder that valued them most highly (generally the investor that could use them most efficiently), a process that might be more costly to achieve if shares were first allocated to customers. Since there are no clear initial owners of the EPBs a decision must be made on how the proceeds of sale should be distributed. Options could include distribution to local or regional governments or a cash disbursement to consumers (e.g. through a credit to electricity accounts). The latter approach might be superior to a share giveaway if individuals are not particularly interested in share ownership - it would reduce the costs and difficulties to individuals of realising the proceeds from share sales. Those individuals that wanted to own shares could use the money credited to their accounts to acquire shares through the sharemarket.
- 2.16 In the case of Municipal Electricity Departments (MEDs), ownership is clearly held by local authorities. Their ownership rights have, appropriately, been recognised in the Bill. However, given the benefits of privatisation, and the record of poor management of trading enterprises by a number of local authorities, the government should encourage and facilitate the privatisation of these operations as it has done in the case of port companies. Ultimately, the government may need to resort to legislation to achieve privatisation.
- 2.17 The Bill limits individual shareholdings in companies formed from EPBs to a maximum of 15 percent except with the approval of the minister of energy. This restriction potentially undermines some of the major gains expected from privatisation. Limits on share concentration restrict the discipline exerted by capital market controls on management performance, preventing the market for corporate control from acting through takeovers. Instead, a change of control can be achieved only through shareholders forming coalitions, a process that is

likely to be more difficult to achieve than a direct amalgamation of shares. The increased difficulty and cost of gaining control and the limited ability of investors to capture the gains from improved performance are likely to reduce the incentives of investors to monitor management performance.

- 2.18 There is a widespread belief, moreover, that further restructuring of the distribution industry is necessary. The restrictions are likely to impede one ESA mounting a takeover for another even though the takeover might result in significant efficiency gains. Instead, only 'friendly' mergers are likely to be achievable. A share cap does not handle concerns about an organisation exercising monopoly power (since all of the individual owners would gain from the higher profits achieved by monopoly pricing). Monopolisation is instead a concern about a single party owning a number of competing ESAs. Such concerns are already handled by the provisions of the Commerce Act.
- 2.19 All holders of electricity distribution company shares will be adversely affected by the restrictions. The threat of takeover and the monitoring by large investors would lead to better managerial performance and a higher share price, a desirable outcome for all shareholders.
- 2.20 In summary, the Business Roundtable supports government moves to corporatise ESAs and to allow privatisation. In our view these reforms are likely to achieve substantial efficiency gains in the short term. However, if these gains are to be sustained and pursued with vigour on an ongoing basis, the government needs to move more quickly to achieve privatisation. This will overcome the longer-term problems experienced with the SOE process, remove concerns about the role of Trusts and trustees, and ensure a clear, well-focused process of reform. Removal of the ownership restrictions would ensure that the maximum benefits from exposing distribution companies to capital markets were obtained.

3.0 Deregulation

- 3.1 The Energy Sector Reform Bill removes the franchise monopoly protection previously enjoyed by ESAs but still requires an order in council before a person can commence operating as an electricity distributor. It introduces a 'light-handed' regulatory regime involving principally disclosure requirements but also provides for the introduction of price controls for electricity distributed to domestic premises. These issues are discussed below.
- 3.2 The removal of the major regulatory barriers to entry into franchise areas is an important improvement over the status quo. However, the requirement that the minister approve new entrants to the market constitutes an ongoing barrier to entry. There are usually major economic costs associated with imposing regulatory barriers to entry:
- Regulatory barriers confer on an incumbent firm a degree of market power which it would not have enjoyed in the absence of such protection. This means that, to an increased extent, the firm can restrict its output, raise its price, reduce its product quality or restrict its product range without losing custom. By contrast, free entry and the threat of competition will generally

encourage a firm to produce and price efficiently, and to adopt the most efficient organisational structure.

- Because regulatory barriers are imposed by government, the organisations involved tend to be more susceptible to government interference in day-to-day business affairs and to politically-motivated interventions designed to favour powerful interest groups at the expense of the wider community.
- 3.3 Because competition and the threat of competition are the most effective constraints on monopoly power, the Business Roundtable believes that all remaining barriers to entry should be removed, including the requirement for ministerial approval prior to entry. This would place electricity on the same footing as the great majority of other industries in New Zealand. This does not preclude the enforcement of safety standards (although in some circumstances such requirements have also been used as anticompetitive barriers to entry).
- 3.4 The government has proposed that ESAs be subject to a 'light-handed' regulatory regime which requires disclosure of pricing and financial information. Regardless of whether the ESAs are subject to explicit regulation, as long as there are concerns about their potential monopoly power they will be subject to the threat of regulation. One possible response by the organisations concerned would be to supply information on pricing and profits which could assure consumers that the company was not earning monopoly profits. If so, the imposition of a disclosure regime may not impose serious costs. Indeed, a formal disclosure regime may deflect pressure for more costly and inefficient regulatory arrangements. However, to the extent that the information required exceeds that which would be supplied voluntarily, the disclosure regime inevitably imposes costs. In addition, there is a danger that regulated firms will be forced to release commercially sensitive information which competitors can use to their own advantage. This could be a legitimate concern for some industry participants in respect of contracts with major electricity users. The requirement to disclose the terms of such contracts removes many of the incentives for suppliers to develop innovative arrangements with customers. The consequences for the regulated organisation may therefore be costly. Because of these concerns the requirement for disclosure regulation should be reviewed at a later date as the reforms lead to increasing competitive pressure on distribution companies.
- 3.5 The Bill provides for the implementation of price controls on electricity delivered to domestic premises in the period to 1997. This is a major retrograde step, increasing the risk for investors that price controls will be imposed for political rather than economic efficiency reasons and that some households will be advantaged at the expense of businesses. Consultants to the government on electricity industry restructuring have repeatedly advised against price controls, and the measure appears to be politically-motivated rather than having a sound economic rationale.
- 3.6 Our concern that the price control provisions of the Bill would be used to reimpose inefficient and costly cross-subsidisation of domestic consumers is reinforced by the observation that throughout the world subsidisation of households at the expense of businesses has been a common phenomenon for

many utility services, and has certainly been the case in New Zealand for telecommunications, electricity and gas.

- 3.7 This possibility is of major concern. One of the key benefits of corporatising the ESAs and giving them a commercial mandate is the incentive this provides for efficient pricing. Controls on prices (or wages, rents, interest and other assets and factors of production) have disastrous effects on resource allocation and growth in a market economy. New Zealand's lamentable record of economic performance owes much to interventions of this kind. The measure appears to be motivated by a fear of increased prices. However, electricity prices like any others should be allowed to reflect underlying conditions of supply and demand. Lower prices are not necessarily better (even though the electricity reforms as a whole will encourage lower prices). What is really of importance to consumers and the economy as a whole is **efficient** pricing.
- 3.8 A basic principle of efficient pricing is that the price of a particular good or service should at least cover the marginal (or incremental or avoidable) costs of producing it. This is fundamental because, in general, if prices fall below marginal costs, consumers do not bear the costs of the resources that are consumed in producing the goods or services in question, i.e. the value of the service is less than the cost of producing it and resources are wasted. Those resources could have been devoted to producing alternative services which consumers would have preferred. The pricing of electricity to domestic and rural consumers below the cost of supply has meant that they have not faced the true costs of electricity supply. As a result resources have been wasted, incentives for energy efficiency have been weakened and distribution companies have been encouraged to over-invest in assets needed to supply domestic consumers. If, as has been suggested, there are situations where prices would need to be raised by 100 percent, that should be regarded as a scandalous state of affairs since it implies sales are currently being made at half the costs of production. The removal of the under-pricing will therefore translate into a substantial improvement in the overall wealth of New Zealanders.
- 3.9 A further difficulty about regulations such as price controls is that they tend to spawn other regulations. If the price control regulations are onerous, they may need to be accompanied by the reimposition of the obligation to supply and of franchise areas. Otherwise, for example, if distribution companies are forced to supply customers for a price that does not cover costs, they may choose not to supply those customers. Thus, price control could lead to re-regulation and a reversal of the major gains expected from the reforms. It would also be likely to reduce the sale value of all ESAs, since buyers would discount bids against the risk of future profits being constrained by government intervention.
- 3.10 The only valid economic reason for wanting to restrain prices is to prevent firms charging consumers monopoly prices. However, in this regard the proposed pricing provisions are redundant. Consumers are already protected against the abuse of monopoly power by the price control provisions of the Commerce Act. Because the Commerce Commission monitors all industries, it is less subject to capture by particular interest groups than would be the case with the provisions proposed in the Energy Sector Reform Bill. The Commerce Act provisions have been tested in practice and substantial case law exists to assist both the regulators

and the regulated in respect of pricing regimes. Accordingly we recommend that the provisions proposed in the Bill be deleted.

- 3.11 In summary, although the Business Roundtable supports the proposed deregulation of the energy market, we believe that unnecessary restrictions have been maintained in the Bill. In particular, the remaining barriers to entry to electricity distribution should be removed, the price control provisions should be eliminated and provision should be made to review the need for the disclosure regime, say, in two years' time.

4.0 Concerns About Deregulation and Privatisation

- 4.1 Opponents of the reforms canvassed in this submission suggest that corporatisation and privatisation may increase prices to some consumers. This outcome is possible but, provided it is not due to anticompetitive factors, it will be consistent with better resource use, and even in the case of affected consumers the first-round impact will generally be outweighed by the major indirect and longer run benefits achieved by these reforms. The reforms are intended to provide incentives for electricity distributors to price distribution services in a more efficient manner. Although this may result in an increase in prices for those consumers that have been heavily cross-subsidised in the past, overall it will allow prices to other consumers to be reduced; electricity assets will be used more efficiently; and decisions on future investment will be more soundly based. The experience with telecommunications reform reinforces these conclusions. The rebalancing of tariffs has allowed substantial reductions in toll calls, the benefits of which have generally far outweighed any increases in domestic rental charges. In the current case, any adverse pricing outcome for particular customers must be balanced against the substantial improvements in performance and particularly the expected reductions in costs that will accompany the corporatisation and privatisation of the ESAs. The indirect benefits of a more efficient distribution sector in the form of lower prices for all goods and services using electricity as an input is the crucial factor for consumers, since direct electricity charges typically represent only a small proportion of household budgets.
- 4.2 The under-pricing of electricity to domestic consumers has been possible because of the over-pricing of electricity to industrial and commercial consumers. The higher prices have deterred industrial and commercial customers from an efficient level of electricity purchases even though they were prepared to meet the true costs of production. The distortions in the relative prices of different energy forms have resulted in some firms using alternative sources of energy despite higher real resource costs. The result has been a lower level of production of the goods and services produced by the firms concerned, higher prices for their output, a lower level of employment and a misallocation of energy resources. A removal of the cross-subsidy is likely to lead to increased output and employment and a reduction in the cost of goods and services produced. Domestic consumers will benefit from these lower prices and from improvements in employment opportunities generated by firms expanding output. Rural consumers will directly benefit from the lower costs of processing farm products that are sold in export markets. For example, lower electricity prices to industry will reduce the costs of cool storage and the costs of dairy and

meat processing. Efficiency improvements of this kind lower the real exchange rate for internationally trading industries.

- 4.3 An important outcome of the adoption of efficient prices will be the better signalling of demand for new capacity. This is especially important in a high capital cost industry like electricity where there are long lead times and where incorrect investment timing decisions can be very costly. Better cost-based pricing can be used to improve load factors and to delay the requirement for new investment by shifting usage away from peak periods. A delay in the requirement to build new generation and transmission plant will bring substantial environmental benefits. More efficient prices will better signal the appropriate balance between investments in energy efficiency technology and new generating capacity.
- 4.4 Concerns about the pricing implications of the reforms may well be overstated given the dramatic reductions in costs that can be expected to accompany the reform process. It is often suggested by ESAs that they have little control over the prices they charge since the largest cost item to them is the wholesale price of electricity. This is misleading as ESA costs typically account for 30 percent or more of the price to the final consumer. If ESA costs were to be reduced by a third (roughly the level which the Electricity Corporation is now approaching) and applied to price reductions, electricity prices could fall by an average of 10 percent.
- 4.5 Given the unusual organisational structures of EPBs, the lack of accountability of management and boards to consumers, and uncertainty about ownership in the past, the potential for performance gains is likely to be even greater than for some of the SOEs. For example, the electricity distribution reform unit has suggested that reform could allow a reduction in staffing by up to 30 percent of staff of ESAs (i.e. 2,000 people). Since staff constitute a high proportion of supply authority expenses, their displacement is likely to substantially reduce the cost of electricity supply. The reform unit has also noted the tendency of supply authorities to 'gold plate' systems with over-engineering and expensive buildings. For example, the international norm for transformer capacity to peak electricity load is 2.5 times whereas the ratio in New Zealand is three to nine times. The pressures arising from corporatisation and privatisation will prevent such cost-padding in the future. Competition will also provide incentives for the distribution companies to provide services that are valued by customers such as more flexible bill payment options and discounts for prompt payment.
- 4.6 The rate of return and therefore the valuation of the assets of the distribution companies will be determined to a large extent by pricing policies that can be adopted in the face of competition between companies, constraints imposed by alternative options for electricity supply (e.g. grid bypass) and alternative energy forms. These pressures can be increased by removing any remaining barriers to entry (as suggested above); more quickly removing the obligation to supply; ensuring that there are no restrictions on mergers or restructuring (within the constraints imposed by the Commerce Act) and allowing the Electricity Corporation to offer retail services and to supply major new customers. It is incorrect to suggest that the requirements to place a proper commercial value on assets and to earn a commercial rate of return will push prices up. Several years

of experience with the SOE reforms demonstrate conclusively that the opposite is the case. Although the Bill does not prescribe the valuation approach or required rate of return, the methodology adopted for Transpower has met with general acceptance and is likely to be an appropriate starting point for the distribution companies.

- 4.7 In summary, more efficient pricing is expected to be a major benefit of the proposed reform programme. The removal of inefficient cross-subsidies is likely to lead to increases in output and employment in firms that are currently burdened by over-priced electricity. Corporatisation and privatisation of distribution companies is likely to lead to substantial reductions in operating costs. This will soften the impact of change for those customers that have, in the past, benefited from cross-subsidies at the expense of others in the community. Overall the improvements in the efficiency with which resources are used will result in a net increase in economic welfare.

5.0 Summary of Suggested Improvements to the Bill

- 5.1 The key recommendations of this submission are as follows:

- The Business Roundtable supports the government's moves to corporatise ESAs and facilitate moves to privatise them. However, we believe the government should be adopting a more straightforward approach to the privatisation of EPBs and MEDs. This would overcome the difficulties with Trusts and would ensure that the maximum benefits from commercialising electricity distributors are achieved as quickly as possible.
- Privatisation of EPBs could be achieved by a giveaway of shares to consumers. Because there is no clear entitlement to ownership, a pragmatic and simple approach to the allocation of shares could be adopted.
- An alternative would be the sale of the EPBs through a negotiated process (possibly with a partial share float) and the distribution of the proceeds to local or regional governments or consumers.
- The government should actively encourage the privatisation of MEDs.
- The government should remove the proposed limit on individual shareholdings since this acts to the disadvantage of all shareholders, and weakens the incentives for management performance provided by capital market constraints.
- Because competition and the threat of competition are the most effective constraints on monopoly power, the Business Roundtable believes that all remaining barriers to entry by competing electricity operations should be removed.
- The government should review the need for the disclosure regime after, say, two years.

- The proposed price control provisions, if applied, would lead to a misallocation of resources and increase the risk of re-regulation of the electricity industry for political rather than economic efficiency reasons. The provisions are not needed to protect domestic consumers from the possible abuse of monopoly power since such protection is already provided by the Commerce Act. Accordingly they should be abandoned.