

John Ernst, **Who's Utility: The Social Impact of Public Utility Privatisation and Regulation in Britain**, Open University Press, Buckingham, 1994, x + 225pp. RRP \$49.95, and

Stephen King and Rodney Maddock, **Unlocking the Infrastructure: The Reform of Public Utilities in Australia**, Allen and Unwin, Sydney, 1996, vii + 190pp. RRP \$29.95.

Reviewed by Michael Johnson*

The provision of infrastructural services delivered through a network, such as railways, telecommunications, water services, electricity and gas were initially provided by the private sector in countries like Britain and Australia but then were taken over and developed by the state. From the end of the 1970's in Britain and subsequently in Australia commercialisation and privatisation of firstly economic and subsequently social infrastructure has reversed the historical trend. The commercial and corporate reforms undertaken in pursuit of market based efficiencies, cuts in the public sector borrowing requirement and other objectives have fundamentally changed the relationship between the producers and consumers of public services and in some cases led to fundamental restructuring of industry institutions. The changes have also introduced the challenge of developing appropriate regulatory mechanisms for what, even after restructuring and changed ownership, often remain natural monopolies. Reflecting a widespread interest in what rapidly became the cornerstone of public policy reform there were a number of early books published on the subject in Britain and Australia (see Vickers and Yarrow, 1989 and Abelson, 1987). After the initial phase of interest in the changes, a second wave of books, like those reviewed here, is beginning to explore the origins, processes and impact of these developments and promote or oppose it.

The first of the books reviewed here is John Ernst's 'Whose Utility?: The Social Impact of Public Utility Privatisation and Regulation in Britain' published in 1994, which looks at the evolution of the two closely related developments mentioned in the title and their impact on the water, electricity and gas industries in Britain. The book is organised into 7 chapters and starts with two chapters on the emergence of the privatisation process and the development of a regulatory framework to manage it in the country that led the world in a wave of privatisation reforms that have been followed by most countries in the world. The development of the regulatory arrangements in Britain soon after the declaration of the intent to privatise is

* School of Social Science and Policy, The University of New South Wales

explored by Ernst in more detail in Chapter 2. An analysis of the outcomes of privatisation for consumers, which are the core concerns of the book, are explored in chapters 4, 5 and 6 dealing with prices and tariffs; the management of debt and disconnection and consumer protection and representation. His conclusions are summed up in the final chapter where he suggests:

... the defects of the British model of privatisation are such that much more than a marginal tinkering will be required to correct them. The paradigm around which the privatisation program has been framed is inconsistent with the basic function and importance of public utility services in the lives of individuals, families and in the economy generally (Ernst, p. 196).

By way of contrast to Ernst's evaluation of the effects of British commercialisation and privatisation of infrastructure the second book reviewed, 'Unlocking the Infrastructure: The Reform of Public Utilities in Australia' by Stephen King and Rodney Maddock (published in 1996) takes more of a 'how to' in Australia approach to introducing market institutions. It does so from the current microeconomic policy viewpoint that gives primacy to enhancing competition. This book marks the start of the development of text books on introducing market institutions in Australia. It is designed to enhance its value by taking upper level undergraduate economic and public policy students through the theory and policy analysis necessary to ensure that the commercialisation and corporate change process creates as competitive environment as possible.

To achieve its goals the material in the book is organised into 10 chapters starting with introductions to the role of infrastructure and National Competition Policy with a major focus on telecommunications, in which both the authors have considerable experience. The cases of posts, electricity and water are also considered. The introductory material is followed by extensive chapters on market pricing, natural monopoly, market access and investment issues, regulatory regimes, case studies of reform and the fundamental change that has taken place in infrastructural policy as a result. The book contains a useful and reasonably comprehensive index which is in sharp contrast with the short and abbreviated index in the Ernst book which has limited usefulness and is disappointing in a book published by Open University Press, presumably for students to use.

Neither book explores the extension of the process of commercialisation, privatisation and market structures to other parts of the infrastructure already partly or wholly organised along business lines such as airports; or into the social infrastructure managed by government departments and

agencies that is now becoming subject to the same process. A process that has led to the creation of thousands of crown agencies in Britain. A process that is beginning to be followed in Australia through the breaking up of the management of public programs and privatisation as part of the extension of mechanisms to ensure 'competitive neutrality' and therefore competition between public sector agencies and private or 'not for profit' bodies. Both books are very limited in their international comparisons, which is a major disappointment. In their studies of Britain and Australia both books refer to the 'de jure' regulatory style of the United States but do not examine it in any detail. King and Maddock reject it as a model for Australia along with what they call the 'heavy handed' approach of Britain. This omission and rejection cannot easily be justified in Australia. The British approach has been adopted by Victoria, while society in many areas is developing the same litigious approach for preserving individual rights as the US and is likely to increasingly adopt their regulatory structures as well – even if it is acknowledged as costly.

As one would expect price setting and costs are a central focus of the analysis of both books, canvassing the same theories, though Ernst focusses on the pricing results. The question of the treatment of social costs in particular is recognised and treated as a key issue in 'Whose Utility' but hardly mentioned in the King and Maddock volume, which is disappointing given its importance. They do put forward in detail a short run marginal cost pricing model as the optimal model (pp. 48-66) and suggest that where this can be applied competition is 'feasible' and regulation is unnecessary. This seems to reflect the questionable 'contestability' supposition which assumes that if there is even a possibility of competition in a particular area of the economy, then regulation is considered unnecessary. This problem may be the reason why King and Maddock like some others like to promote bench marking and other means to promote efficiency and effectiveness. A move that will work best, it must be pointed out, while industries are publicly owned as governments can demand the information to make it work. It might also be noted that the law can be used to open up privatised industries to bench mark them, although it can lead to entities being 'shadow managed' by regulators as they often are in the United States.

The introduction of commercialisation, corporatisation and privatisation that make up the introduction of market reforms are designed primarily, it is usually claimed, to provide consumers with lower priced, better quality services. The evidence now available from Britain about the reforms is not encouraging. Ernst reports increases in the prices of water and electricity while the price of gas, along with international prices fell. Studies after

Ernst's work show that prices for domestic water service consumers rose by 67 per cent in Britain on average between 1989/90 and 1994/5. In turn 46 per cent of water consumers in the South of England thought water price rises were unreasonable in 1993, a significant rise on 1990 (Johnson and Paddon, 1995). These developments will be avoided in Australia, King and Maddock claim, because the Australian process is focussed on competition while they suggest that in Britain it was not as 'the firms were privatised at too low a price in order to pursue the Conservative Party's objective of the popularising of shares' (King and Maddock, p. 32). This attempt to distance the Australian case from that of Britain, which is clearly more advanced while based on similar theoretical premises as Australia is, I would suggest, wrong. The bottom line result, privatisation, is exactly the same in Victoria, which has pursued privatisation with the same zeal as in Britain. Unlike Britain, Victoria has not attempted to extend popular Capitalism but has usually privatised through trade sales to single companies or consortiums with strong foreign ownership with results that are not yet at all clear.

One objective of these reforms is to improve the returns on the nation's capital, which is justified because Australian utilities, like the water authorities of the past 'made low or even negative returns on capital, they have operated with the intention of covering direct costs' as King and Maddock note (p. 20). While this was once true, it has not been the case in recent times and detailed studies show they have made handsome returns in recent years under public ownership – better than your average share market quoted private company (Walker, 1993: 208-209). This would support the King and Maddock contention in principle that the ownership of infrastructure should not matter in the search for economic efficiency. This is clearly not so in practice where privatisation is pursued as it is believed this locks in the benefits of a market orientation. This belief is clearly wrong. More recent evidence than Ernst's work from the UK shows that privatisation has 'locked in' high profits for the privatised infrastructure companies there and made its former public sector managers seriously rich in the process at the expense of consumers (see Fraser, 1996).

Both theory and recent experience show that the question of quality is of key importance in discussions about contestability, natural monopolies and regulation. The quality of services in Britain, according to Ernst, has been compromised extensively since privatisation. King and Maddock's however deal lightly with the issue of quality, mentioning it twice! This is in relation to the question of the difficulty of maintaining quality when vertical separation of industries such as water is created. One reason for this may be the heavy preoccupation with prices throughout the book, which is

understandable, but questions of maintaining the quality of services where there are monopolistic elements or asymmetry in information is also obviously important for maintaining competition past the reform point.

In terms of the usefulness of the books for teaching, 'Unlocking the Infrastructure' would provide a useful undergraduate text in courses looking at infrastructure and regulation but requires support from more comprehensive texts dealing with the specific industries being studied and the outcomes of the reforms. King and Maddock's work is also useful because it outlines the rationale of the National Competition Policy and the way it has been implemented. An implementation process about which it has serious reservations, for example in relation to access rules and other matters. These concerns indicate the awareness by King and Maddock of the serious obstacles that will have to be addressed if the policy is going to work. However the work also requires balance from viewpoints like Ernst's, which indicates the human dimension of the issues and the consequences when the solutions to perceived problems are unrealistic. In relation to Ernst's book, its British focus is obviously a limitation for use in the Australian context, but because it covers the lessons learned it has universal relevance and provides an important counterfactual to King and Maddock's positive evaluation of the benefits of market reform of utilities and privatisation.

It should be pointed out that the obvious limitations of the competition policy are indicated by King and Maddock. These include the previously mentioned problems of creating initial contestability and much more importantly making it continue. Problems that have a particular relevance in the Australian case given the power and universal application of the access rules put into law. Rules they point out, that could make large parts of private infrastructure subject to its coverage and potentially open to regulation by the Australian Competition and Consumer Commission. This is an interesting development given the original intention of the reforms was to reduce the capacity of the public sector to opt out of the reforms. King and Maddock also indicate how state regulatory regimes are uncoordinated and in some areas such as electricity there is evidence of different state and Commonwealth regimes emerging. This all helps indicate how the focus at this stage in the reform process is still on access questions while pricing regimes have not been settled.

The focus on the outcomes of institutional reform in the case of Ernst and implementation issues in King and Maddock means broader issues relating to the overall industry structure of infrastructure, or the adequacy of the present level of investment in infrastructure are not explored in detail

in either book. This is a bit of a disappointment as it would place the scale and scope of these reforms in context. The provision of capital is only explored in any detail in relation to regulation in both volumes. The important impact of infrastructure on public sector finances is explored in relation to debt and the public sector borrowing requirement in relation to privatisation by Ernst, but is not discussed in any detail in King and Maddock at all.

In relation to the forecasted macroeconomic effects of the reforms, for instance those by the Industry Commission, the major driver of the National Competition Policy in Australia, there is only brief reference in the King and Maddock's work and no analysis. The book is almost solely concerned with microeconomic issues after a brief mention of the policy context in the early part of the book. This is a disappointing omission as this work has been used by governments to sell the reforms to the public. The Ernst volume in contrast does concern itself throughout with wider public policy issues, but while addressing budgetary issues does not analyse them in detail. In relation to these issues Ernst does concern himself with issues such as the impact of privatisation on wider policy matters such as energy policy, where in the British case, there has been a major impact on the coal and gas policy, the serious implications of which are only just being understood.

In conclusion, the books by King and Maddock and by Ernst are important contributions as they mark the start of a more comprehensive analysis of the theory and process of infrastructure reform. They analyse the issue from quite different perspectives in different countries but complement each other by throwing much more light on the subject jointly than either does alone. They also indicate how much more work has still to be done in Australia if the policy is to be made to work evenly remotely like its protagonists suggest it can.

References

- Abelson, P. (ed) (1987) *Privatisation: An Australian Perspective*, Australian Professional Publications, Sydney.
- Fraser, R. (1996) 'Privatisation in the United Kingdom: Lessons for Australia', *Economic Papers*, Vol. 15, No. 4.
- Johnson, M. (1992) 'Evaluating the Privatisation of the English and Welsh Water Industry', *The Economic and Labour Relations Review*, Vol. 3, No. 2, pp. 72-92.
- Johnson, M. and Paddon, M. (1995) 'Keeping Our Heads Above Water: Is Privatisation of NSW Water Industry Inevitable?', Public Sector Research Centre Research Paper.

- Vickers, J. and Yarrow, G. (1989) 'Privatisation in Britain', in MacAvoy, P.W. et al *Privatisation and State Owned Enterprises*, Kluwer Academic Publishers, Boston.
- Walker, R.G. (1993) 'Evaluating the Financial Performance of Australian Water Authorities' in Johnson, M. and Rix, S. (eds), *Water in Australia: Managing Economic, Environmental and Community Reform*, Pluto Press, Sydney.