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**TRANSCRIPT
OF PROCEEDINGS**

PRODUCTIVITY COMMISSION

**INQUIRY INTO THE IMPACT OF COMPETITION POLICY REFORMS ON
RURAL AND REGIONAL AUSTRALIA**

**MR J. COSGROVE, Presiding Commissioner
MR R. BRAITHWAITE, Associate Commissioner**

TRANSCRIPT OF PROCEEDINGS

AT CANBERRA ON TUESDAY, 20 JULY 1999, AT 11.05 AM

Continued from 14/7/99 in Townsville

MR COSGROVE: We will commence this Canberra hearing on the commission's draft report into the impact of competition policy reforms on rural and regional Australia. We're conducting these hearings in as an informal a manner as we can, but in order to help us to improve the quality of our final report to the government, we do ask participants to be accurate in the information they provide to us. We have been seeking in the hearings in particular factual evidence on the impacts of competition policy reforms as well as reactions to the assessments contained in the draft report.

I'll ask participants when they come to the table to my right to identify themselves and the capacities in which they are appearing before us today. The hearings, as you will see, are being recorded and transcripts of them will be made publicly available, including on the commission's own Web site, and members of our staff who are present today will be able to explain to you how to obtain a hard copy of the transcript if you wish to do so.

Without any further ado, I think I'll ask our first participant today, the National Farmers Federation, to identify yourselves and your organisation.

MR RITCHIE: Thank you, John. Todd Ritchie from National Farmers Federation.

MR COSGROVE: Thanks, Todd. We had an initial submission from the federation. There are further points that you want to draw to our attention, I imagine.

MR RITCHIE: That's right. First of all, can I apologise for Brendan Stewart, the chairman of our committee, who hoped to be here, but matters on the farm have kept him away. Bob Lim and Terry Dwyer will be joining me, hopefully. They are currently doing a project on infrastructure pricing and adequacy and they're the experts on that area although I will make a few general comments before passing over to them.

First of all, let me thank you for the opportunity to appear before the commission and discuss the draft report. It is obviously an issue of great importance to regional Australia. Also, can I commend the commission for the breadth of issues covered in the report. It is certainly an intimidating document. As you would expect, with a document of this size it wouldn't be any surprise that we do have a number of concerns, and I'll go through them and make some general comments first about national competition policy before covering some of the specific areas raised in the document.

The impact of national competition policy - I'll refer to that as NCP from now on to save some words - in regional areas: it's crucial for regional communities to be viable and employment opportunities maximised. They must have strong industries, a vibrant rural sector, equitable and affordable access to infrastructure and social services. As we indicated in our original submission, after more than three years of the application of competition policy, a range of concerns are being expressed in rural and regional Australia. These includes fears of reduction in or increased costs of

services, changes to cooperative marketing arrangements, increased farm input costs - with particular emphasis on water - and an uneven distribution of the benefits and costs, with the costs being borne by regional Australia and the benefits accruing largely to metropolitan areas and big business.

Rural and regional Australia sees itself singled out for disruptive reform processes while other parts of the economy that are also uncompetitive remain untouched. Should reform address only some areas of competitive failure and not others then only some industries will benefit and these may not necessarily be those in which Australia has a comparative advantage. The implicit bias created by partial reform would move Australia from one distorted economic structure to another distorted structure with little gain in economic welfare.

In addressing this issue the Productivity Commission report implicitly recognises that the implementation of NCP will create adjustment problems. Governments must play a role in facilitating adjustments to change in those areas where change brings significant dislocation and short-term costs. I should also at this point make reference to our submission with regard to page 186 of the report which selectively quotes arguments for the reform of statutory marketing authorities.

While recognising the possible benefits of reform, the NFF submission explicitly states that the single seller status permits Australian producers to be the single large effective marketeer in the export market, which ensures the maintenance of production efficiencies in our industries. Australia benefits if the statutory marketing authorities can either gain a greater share of the market and/or a better price, as this brings in additional export income.

The notion of community service obligations is also closely related to NCP. CSOs arise in a range of areas including access to health services, provision of water, sewerage, electricity, telecommunication services, quarantine services, education, banking, public transport and mail services. All of these issues are of course covered in the report. In all services that embody a CSO there is a degree of essentiality that underpins the service obligation. They are seen as necessary and important aspects of a minimum standard of living guaranteed by the community. In order that these services are reasonably available to all in the community, pricing must take into account the ability to pay of those in the community. This does not require that pricing always meets the needs of the least well off, although special circumstances can be applied, but pricing must ensure that services are affordable to the overwhelming majority of the population.

One area of NCP with which NFF is particularly concerned is that of the infrastructure provision. As I indicated earlier, Bob and Terry will be expanding on these important issues later, but let me make some preliminary and necessary general observations. The two issues of greatest importance are the adequacy of infrastructure and access to and pricing of infrastructure services. It has long been accepted that governments have a key role in the provision of infrastructure because it may often be impossible for a private provider to reap the benefit of investing in

such

enterprises. The new paradigm that infrastructure costs should be borne by users alone is contrary to economic theory, which stresses that in the case of externalities there will be underprovision of useful infrastructure if the full cost is sought to be recovered from direct users only.

Economic efficiency dictates not a policy of user pays but a policy of beneficiary pays. To the extent that infrastructure reform has meant a shift towards fully commercial models under which the whole cost of infrastructure must be met by users, and by users alone, it may be questioned as being neither rational nor efficient. Under NCP the focus has shifted towards the cost of infrastructure investments and the returns that can be generated by the owners of the infrastructure and away from the community benefits. Competition has ensured that all infrastructure owners focus on financial returns and for rural areas this may create problems.

The critical question in these circumstances is whether investments that are economically valuable will continue to be made or what form of intervention is needed to ensure such investments are made, given the failure of the market to provide sufficient financial incentives. The new emphasis on competition may have sharpened the focus on cost and cost recovery leading to more efficient delivery of services but risks overlooking the consideration of broader economic benefits. The Productivity Commission needs to make a detailed examination of whether the current competition policy is forcing too narrow a definition of costs and cost recovery and overlooking broader economic benefits, thus shutting off investment in rural infrastructure.

In the area of infrastructure transport is also vitally important to country Australia. It is essential that rural centres and primary producers are able to move freight in and out of our regional areas all year round. It is inconceivable that as we approach the 21st century in a Westernised country, large parts of regional Australia can be isolated due to the inadequacy of sections of our national highway network. Unfortunately, road and transport infrastructure investment in Australia for many years has been determined by short-term budgetary pressures rather than the intrinsic value of infrastructure to the national economy. The evidence suggests that this has led to underinvestment in road infrastructure.

A similar lack of investment in rail continues to have a negative effect on potential productivity improvements in Australia's rail industry. There seems little disagreement with the view that rail infrastructure requires substantial investment effort by Commonwealth, state and territory governments and the private sector. Compared with other transport modes rail has fared poorly for investment. The draft commission report from your organisation, Progress In Rail Reform, identified lack of investment in rail as a significant constraint on improvements in rail systems, productivity and their ability to operate more efficiently.

I turn now to some specific aspects of the report. There is much within this report with which NFF agrees. We certainly welcome and agree with the analysis in chapter 2, which highlights the current inequalities between urban and country

Australia, including higher rates of suicide, higher mortality rates, the withering of

small country towns, lower access to and participation in education, below average income levels and higher unemployment rates. As summarised by the commission's own socio-economic disadvantage index, most of remote Australia has some level of socio-economic disadvantage.

We also agree with the analysis in section 4.2 which indicates problems that stakeholders have with the pace of NCP process. This is a very common concern expressed to NFF by just about all of its members. The possibility of mismatch of skills, understanding and resources between the various sides of the NCP debate is also an issue with which NFF has taken exception. Indeed, I feel this very disparity at the moment when I consider the resources that the Productivity Commission and the NCC must have devoted to these issues.

The NFF also agrees with the concerns raised on pages 271-272 about the potential negative impact of compulsory competitive tendering. However, within the report and in the general application of NCP there is a view that local government must explicitly set down the benefits if they don't use outside tenders. If this is to be the case, then why not require an assessment of possible costs if they do tender outside the area to keep the playing field level? This approach appears symptomatic of the NCC approach to NCP where any time a public interest test has been used to support a decision the NCC seems to be all too ready to come down hard on the perpetrators.

Let me now turn to areas of the report with which the NFF disagrees. On page 80 the report states:

It is entirely consistent with competition policy for governments to increase spending on welfare, to increase the level of government funding or subsidise social services to retain business in public ownership -

and so on. Perhaps I should introduce - - -

MR COSGROVE: Yes, when they are comfortable in their chairs, perhaps we can get their names and the capacities in which they're with us today on the tape, please.

MR LIM: Apologies, chairman and co-chairman. My name is Bob Lim. I'm currently an adviser to the NFF on the public research project that we're doing.

DR DWYER: My name is Terry Dwyer and I'm working with Bob Lim on the research project on infrastructure financing.

MR COSGROVE: Thank you. Go ahead.

MR RITCHIE: Let me now turn to areas of the report with which NFF disagrees. I'll just go over that quote again because I think it is particularly important:

It is entirely consistent with competition policy for governments to increase

spending on welfare, to increase the level of government funding or subsidise social services to retain business in public ownership -

and so on. The question needs to be asked, why is it considered efficient and correct for governments to spend money on social welfare, yet spending on infrastructure is considered unnecessary and must be justified in such a rigorous manner?

On page 86, recommendation 4.1 implicitly denies the existence of differential impacts across regions, communities and markets, a proposition that the NFF would reject outright. With regard to recommendation 4.2, also on page 86, we find this at odds with the recent case in Queensland where the NCC has threatened to withhold payments to Queensland because they do not agree with the guidelines adopted by Queensland. The NCC cannot have it both ways. If they encourage governments to make these decisions, they must accept the outcome of those decisions. On page 91 the report suggests that the principles of NCP were unexceptional to the government's concern. We would suggest that these governments all had a vested interest in this. There was very little consultation with the genuine stakeholders at the time.

With regard to chapter 8, the NFF would express some surprise in the balance of this chapter, given the almost universal condemnation of NCP's impact on the provision of local government services that was apparent in the submissions to the report. With regard to the discussion of supermarkets in chapter 12, these are issues taken up by the NFF on other forums, however, it is encouraging to note that the Productivity Commission recognises the potential for some abuse of market power by the major chains. The increasing concentration of ownership in the agribusiness industry and supermarket chains clearly illustrates that within the domestic market there are frequently a large number of participants on only one side of the market, thus violating one of the conditions of perfect competition. This situation is exacerbated because the natural bargaining power is particularly low for agricultural producers who face long lead times, uncertain output and perishable products.

The discussion in chapter 13 is also unbalanced. The commission refers to the range of measures in country Australia but conveniently forgets the even greater and more diverse range of measures centred on metropolitan Australia. Also, where the chapter refers to benefits to rural communities it should be remembered that with infrastructure provisions these benefits flow to all Australians.

I turn now to the issue of adjustment assistance. Everyone talks about adjustment assistance but, as far as the NFF can ascertain, not one dollar has yet flowed to those affected by NCP. These funds have already been appropriated by the state governments to consolidated revenue. Everyone appears to recognise the need to adjust, but where is the money? The NFF suggests that the Productivity Commission could convene a workshop to look at the issue of adjustment assistance in more detail. Also, how does the so-called specific provision of adjustment funds sit with recommendation 14.3, which calls for the use of current, generally available mechanisms to provide adjustment?

Chapter 13 implicitly assumes that NCP is a good thing as it argues for a public interest test to slow down the process beyond 2001. We would ask why not a public interest test to look at extending the process? By definition, if reform is beneficial, which seems to be the mantra of the report - why do we make the assumption that reform is beneficial - why can we not make the alternative assumption that reform is not beneficial and try to justify it from that angle? The report also considers the issue of a public interest test. Matters that need to be considered in the public interest test are diverse and frequently in conflict. For example, satisfying equity in social welfare criteria is frequently antagonistic to efficient allocation of resources. In addition, the breadth of issues that are open for consideration implies a wide range of interests for affected parties.

In closing can I report that the issue of NCP was thoroughly discussed at the NFF's most recent meeting in Longreach where the NFF Council adopted the following concerns that need to be addressed: firstly, the timing of NCP reforms, corresponding as they do with a period of adverse climatic conditions and ongoing weakness in demand of and price for rural commodities; that the economies of contestable and non-contestable markets are different and that the implications of pursuing efficiency gains under NCP will vary across markets; that the privatisation of infrastructure facilities that have already been paid for by past taxes represents an abrogation of the government's responsibility with regard to the equitable provision of these services to all Australians regardless of location; the unduly rapid pace of privatisation of infrastructure assets without consideration of the long-term needs of rural and regional Australia; the pricing implications of the provision of infrastructure services by privatised companies that could result from the sale of these assets at inflated prices with guaranteed rates of return; the adjustment problems faced by rural and regional Australians which will be generally in excess of those faced in metropolitan Australia; that NCP payments from the Commonwealth to the states are absorbed into general revenue without any consideration of compensation payments for areas adversely affected by NCP.

The NFF therefore recommends that the government recognises the important economic contribution of rural and regional Australia to the Australian economy; is fundamentally reliant upon the ongoing provision of infrastructure at affordable prices; that all owners of infrastructure assets be required to meet universal service obligations with regard to the provision of services to rural and regional Australia; that the government recognise that rural and regional Australians, together with other users of infrastructure, are unfairly disadvantaged and inadequately resourced to fully participate in the rapid and diverse range of review processes that are currently under way.

The government should ensure that adequate funding is made available to user groups so that a balanced debate can take place; that increased funds be made available to regions and sectors affected by the implementation of NCP to facilitate adjustment and assist industries to meet the future challenges of growth and development in a competitive environment. Chairman, that's all from me on the general matter and, for the specific issues, I would now like to pass to Bob and Terry

to discuss the issue of infrastructure.

MR LIM: Thank you, chairman, and apologies again for appearing a bit late. As Todd Ritchie would have mentioned, we have been undertaking some work under funding from RDC and with the support of the NFF on pricing and the provision of infrastructure, especially as to the effect on the rural sector. The approach that we have taken in undertaking that work, and which we feel should be also applicable to how the Productivity Commission approaches its review, was to go back to first principles.

Prof Fred Hilmer, the grandfather of competition policy in this country - I should say father rather than grandfather - to go back to what Hilmer was all about, Fred really was talking about competition reform and international competitiveness and felt that those two things were very closely linked. He felt that with competition reform we should be getting some benefits like lower prices, greater choice, greater efficiency - especially in investment - and, from our point of view, the test of the success or otherwise of the Hilmer competition policy reforms would be how have we fared in terms of the test?

Fred had a number of general benchmarks. One of them is the issue of national consistency across industries. He had envisaged a national regime which was consistent across industries under a single legal framework and to avoid industry-specific frameworks. The current position as we can see, especially in the energy sectors, is we do have industry specific codes with significant variations within a national framework of the National Competition Policy Reform Act? We also have state based regulation. We have the ACCC involved and, within the electricity reform sector, we also have a number of institutions called the National Electricity Court Administrator which is a quasi-regulator and something called a National Electricity Marketing Company which operates the pool system. So we do have a range or, what one would call, several layers, if you like, of regulation and institutions operating say in the energy sector.

What we are seeing is a degree of confusion a la the rural sector in terms of coping with this sort of new institution of framework, if you like. There is a fair bit of complexity, and I can cover that later during question and answer time or if opportunity presents itself later. Transaction costs are also rising with the establishment of all the new institutions. For example, if you look at the electricity industry you can find NEMCO fees - the National Electricity Marketing Co - are now starting to be around 50 cents per megawatt hour and they are forecasting it will be around the 45 cent mark over the next two years. If you include ancillary services fees and other fees, the transaction costs are starting to rise in terms of operating within the electricity industry. That is not including the costs of the regulators that have been established; for example, the ACCC as well as the state based regulation.

So this national consistency across the industry benchmark, if you like, which Fred was talking about, we probably are not meeting at all. On top of that of course we are starting to see transaction costs rising. On access pricing, which was another

benchmark that Fred was talking about, he was really talking about access pricing requiring a balance of interest between the asset owners as well as the consumers. He didn't think that asset valuation and rates of return were central issues and that the whole basis of competition reforms was on the end position beyond incentives and dynamic gains.

The current situation, as we can see it, appears to be an emphasis on asset valuation and rates of return. Governments, for example, prior to privatising their assets, have tended to push up the asset valuation of the assets that they are seeking to sell and of course they have been ensuring too that they make claims to very high rates of return for those assets.

MR COSGROVE: Bob, I am sorry to interrupt you at that point but we are not here investigating what Fred Hilmer said in his report. We are investigating what the Australian government has agreed to implement as national competition policy. In this specific area is there any significant difference between the two?

MR LIM: No, not at all. We were approaching it in terms of looking at what the Hilmer reforms were seeking to achieve. I guess the National Competition Policy Reform Act was seeking to implement what the Hilmer reform reports were - - -

MR COSGROVE: In most respects - not entirely.

MR LIM: Yes, in many respects, but we were accepting that as a benchmark. But if you want me to be more explicit, certainly the current situation whereby governments seeking to privatise their assets are seeking to raise their asset values - there has been that focus on asset valuation methodology called depreciated optimised replacement cost which tends to produce high asset values and therefore high transportation prices and high tariffs. The regulators, like the ACCC, have been pursuing something called building blocks and cost-plus precision to the extent that they look at rates of return based on capital asset pricing models. In other words, what I am trying to get across, chairman, is part of the regulatory process has become quite complex - complex in terms of government interference and complex in terms of regulators applying very complex methods of arriving at rates of term.

I would like to then perhaps point out very quickly the outcomes in electricity that have arisen. In electricity, we believe that the beneficiaries have been contested customers, as the report quite rightly pointed out, but we also see that the beneficiaries have also included owners of networks - the monopoly lines. I think the report quite rightly pointed out to you the competition at the generator level, say on electricity - and with a key aspect of national competition policy access pricing for the monopoly lines, we have a couple of charts which I will leave with the commission which will show that in fact the trends in network charges have hardly moved down at all over the last four or five years although retail prices of electricity have come down quite significantly. So one aspect of Hilmer was to try and get efficient pricing and lower pricing, if you like, of the monopoly lines.

We have also a chart showing the returns on the New South Wales, for example, network businesses; they have actually been climbing quite significantly. So perhaps there might be some value in pointing out the fact that, in areas where there is no competition, prices haven't come down as much as they should have and that perhaps governments have been capturing the gains in the non-competitive areas. We also have a chart, which again I will leave with the commission, which shows the differences in market prices for electricity in the different states. You will find, for example, that the average price since January 1999 for New South Wales at about \$22 per megawatt hour, compared with \$23.5 for Victoria and these are the two states where there is most competition. But in areas where there is little or no competition, as in Queensland, you have \$58.4 per megawatt hour and in South Australia you have \$49.3.

It is worth just underlining the point that I am trying to make, and which I believe the report should be making, that in areas where there is no competition or less competition the price gains haven't come across. In areas where there are monopoly lines, monopoly infrastructure, the regulation of that monopoly structure does not appear to be delivering the significant price outcomes that one would hope for under Hilmer or under the national competition policy. The reasons that I've pointed out about asset values, privatisation objectives - these are important factors that may explain some of the lack of competition, the fact that the monopolies lines are not delivering price benefits because governments are capturing much of the gains.

I move onto the outcomes in gas and I could point to the fact that for gas transportation charges in New South Wales, under the 1997 access arrangement that was delivered, the contract market revenues were set to fall from \$140 million in 96-97 to \$84 million in 2000 and network charges were set to fall by more than 50 per cent on average. Basically, the large users have been getting most of the gains in terms of lower transportation charges and, to a lesser extent, lower gas prices, but the reductions in retail prices for end users is a bit more questionable.

So what I'm trying to suggest is that with the competition policy reforms in the gas sector, the emphasis on that had been basically on access pricing for the monopoly networks; that the competition policy reforms haven't really applied downstream from the monopoly lines and upstream from the monopoly lines, and perhaps the Productivity Commission should be making a stronger distinction in those sort of situations and make the point that in areas where some access pricing arrangements are being done, prices have come down, but in areas where the reforms haven't bitten, there's no evidence that prices have actually come down.

In fact, if you ask the Australian Gas Association, they will actually say that the share of gas in energy consumption has actually fallen in recent years and that, in a sense, might reflect whether there are differences in competition. Perhaps I should leave it at that, chairman, and just make the point that some of the things that we've talked about - the differences in competition, regulation of monopoly lines, the fact that asset valuations do influence outcomes, and especially by governments, the

rising confusion and complexity and the rising transactions cost - are important aspects in

the energy areas which could be applied to other economic infrastructure areas as well.

MR COSGROVE: Yes. Mr Dwyer.

DR DWYER: Thank you, Mr Chairman. My interest in this goes back, I suppose, to my interest from an academic point of view and the theory of all of this. When Bob was at the Business Council, Terry Larkin and I wrote a report on refocusing micro-economic reform and I'm pleased to see that some of the themes that we stressed there have been picked up by the Productivity Commission in its later work. But I think it's very important in examining a report like this and thinking about things to try to get one's theoretical structure right before one draws conclusions. In all reasoning, there is usually an implicit model and I'd like to suggest to you there are few questions that, in redrafting the report, you might like to look at.

The first question is the question of externality, which generally appears to be given not much notice in the report, but it does raise fundamental questions. The question really is why is it efficient to have a national competition policy which ignores externalities by requiring that all infrastructure be financed solely by user charges and excessive marginal cost? Why shouldn't beneficiaries, as well as users, be required to pay? Now, while Harold Hotelling may have been wrong in his 1938 "Econometrica" article on the General Welfare and Relation to Problems of Taxation and of Railway and Utility Rates, in suggesting that income or inheritance taxes were an appropriate means of financing in for marginal losses of utilities operating on efficient margin cost-pricing principles, he was not necessarily wrong in pointing to rates on land values as an efficient means of recouping benefits from externalities and financing in for marginal losses.

In this sense, the Australian practice of financing public water utilities by rates on unimproved land or site values was more efficient than the user charges which are replacing it. I do find it, as an Australian, somewhat distressing to see that the draft report confuses in its terminology the Australian practice of rating unimproved land values with the American property tax. This country doesn't have the American property tax. The history of the two taxes, their methods and their incidence are quite different.

The next question which seems to be raised by the implicit theory in the paper - the requirement that all new infrastructure not be "subsidised" - is inconsistent with orthodox economic theory. Orthodox economic theory requires that projects should be undertaken if all benefits exceed all costs, including both private and social costs and benefits. Governments should "subsidise" infrastructure if there are external benefits the private sector could not capture, including external benefits to the government as a tax collector. Governments, through taxation, can internalise benefits in a way which private sector providers of infrastructure cannot, and I can give you a very good example of that. The promoters of the very fast train from Sydney to Canberra were saying at one stage that it would be economic if they could recapture the increase in land values their project would create, but they were not

able

to.

There is another question, too, which is raised over this word "subsidy" which is often used in the report. Before you get to talking about subsidising rural infrastructure, you have to look at a zero tax, zero subsidy world. You cannot talk about subsidisation in the presence of distorting taxation, so before you discuss subsidisation of rural infrastructure, shouldn't you discuss the question of tax impacts under our existing tax system and whether existing taxes are locationally neutral in their effect on rural and regional Australia? Prima facie, for example, zone allowances in the tax system recognise that there are disabilities associated with living and working in remote areas, but they are a very ad hoc small method of recognising it.

In general terms, it could be argued that income and sales taxes may be seen as bearing more harshly on those not enjoying the economies and amenities of living in metropolitan areas, and the reason for this is that to live in a rural or remote or regional area, you have to incur extra costs. You therefore require extra nominal income.

MR COSGROVE: Incur extra costs for some items, not for all.

DR DWYER: Not for all. But the point is there's no modelling or discussion of this in the report. The question isn't even addressed, let alone answered. If extra nominal income is required to compensate for a disability, it's wrong in theory for it to be taxed as remuneration. This has been one of the problems raised with fringe benefits taxation in rural areas. The point is that under an income tax, a penny saved is worth more than a penny earned and therefore it is optimal to relocate yourself under an income tax system to an environment where you can save on expenditures. You avoid boarding-school fees by moving to a city, for example. So those questions are not asked, let alone answered in the report.

MR COSGROVE: I'm not sure we were asked to address them.

DR DWYER: You cannot logically talk about subsidisation before you address the distortions of taxation. In other words, it may not be a subsidy to provide something to people in rural and regional Australia by way of infrastructure to compensate them for the disabilities that are inflicted on them by an existing tax system.

MR COSGROVE: What is it about NCP in the infrastructure area, apart from water, which has anything to say about subsidisation?

DR DWYER: The requirement that basically public utilities should be financed on a full commercial cost-recovery basis.

MR COSGROVE: As I say, outside water, I'm not quite sure that's the case. We have requirements for prices oversight of government business enterprises, to ensure that those which are in a monopoly situation are not extracting unnecessarily high

prices. We've got the requirement for competitive neutrality, which is a quite different

point. We've got a process of the structural reform of public monopolies, which requires that these monopolies set out the commercial objectives of their businesses, the merits of separating natural monopoly elements from competitive elements, how they should meet CSOs and the financial relationships between the monopoly and its owner. Then we have a process of legislative review of anti-competitive legislation and we have the access issues related to infrastructure. I'm not quite sure how you're bringing this into NCP.

DR DWYER: Let me put it this way. Suppose the government of Queensland decides to build a dam - - -

MR COSGROVE: Water I said was a separate case.

DR DWYER: Well, suppose the government of Queensland decides that they will forget about these agreements and they will build a generator and electricity transmission network and price at a loss-making marginal cost and not seek a commercial return. Would they not then be attacked as being in defiance of competitive neutrality, even though that may be economically advantageous?

MR COSGROVE: I think more caught up in a breach of structural reform of a state monopoly, but provided they've set out commercial objectives - - -

DR DWYER: Suppose they don't have commercial objectives. Suppose the government of Queensland does want to do now what it did in the 1850s and say, "We will build railways and operate them at a loss, because we believe that will develop the country." In other words, could you now develop this country on the principles that are implicitly adopted by national competition policy? It wouldn't pay for itself, would it?

MR COSGROVE: If they're operating a monopoly, they could get caught up in that way. Of course, they still have the opportunity to do what they want to do and forego some competition payments under the agreement. Anyway, go on.

DR DWYER: So what I'm driving at is that, as I understand it, the national competition policy principles prohibit any subsidisation which violates commercial neutrality. In other words, you've got to get a commercial rate of return on your assets, and the question I raise - - -

MR COSGROVE: No, I don't think that's the case. As I've said, they can provide community service obligations under the agreement.

DR DWYER: But forget about community service obligations. Suppose I say that it's not a question of community service obligations. I want a price near zero marginal cost and that will involve losses for my enterprise and I'm not doing it as a community service obligation, I'm doing it because that's the economically efficient price to set things at. I want to maximise the use of the infrastructure and the ensuing development of my state. Am I then wrong? Does national competition policy allow

me to do that? As I conceive it, it doesn't. I forfeit these payments by the NCC if I start building infrastructure on that basis and operating it on that basis.

MR COSGROVE: I'm not sure, but I need to give that further thought. I think the CSO issue is still relevant in that context, but I'm not sure how it will work out.

DR DWYER: We can come back to CSOs and the interrelation between what is a CSO and a subsidy.

MR BRAITHWAITE: But in the examples that we've been given so far, certainly the NCC don't recognise a structure as you contemplate with some subsidy without some penalty on the dividend payment.

MR COSGROVE: Provided there's not a genuine CSO, I think, yes.

MR BRAITHWAITE: Yes.

DR DWYER: The other point I'd notice is that there is a great concern in the report about subsidising infrastructure projects for producers, because that's regarded as an inefficient use of capital. But why should there be concerns about subsidising infrastructure for producers, when no such concern or scrutiny is applied to transfer payments? If governments can afford to spend money on transfer payments without seeking recoupment, for example asset test free pensions where the home is ignored, why should there be concern about subsidies to the productive sectors of the community? The government in such a situation is implicitly acting as if the cost of funds is zero, because it's not seeking a commercial rate of return on transfer payments, so why discriminate?

Another question which I don't think is addressed is that where assets historically have been funded by loans or taxes and have already been charged to the consolidated revenue fund, is it not then double-dipping to charge users a rate of return on these assets which effectively cost the government nothing, because it's charged the taxpayers for them?

Another point I think that needs to be dealt with in the report is the implicit theory of jelly capital in it. Now, it is actually a fallacy in economic theory terms to assert that some costs "owe" a rate of return to their government or other owners. That's precisely the fallacy that Harold Hotelling was warning about in his example of the Union Pacific Railroad. On this sort of theory, economic efficiency would be supposed to require that the owners of Roman aqueducts should be charging on the basis of current replacement cost of what has long since become indistinguishable from a natural river. The truth is that sunk capital is not jelly capital. It earns Marshallian quasi-rents, not a rate of interest determined by marginal productivity. Its return, once it exists, is dictated by demand alone.

In the case of infrastructure, once built, it has virtually no other use. It can't be pulled out and moved to another use like a ship. Ex ante, it is true that private capital

will not be invested without the expectation of a profit commensurate with the rate of interest prevailing at the time of the investment, but ex post, no-one has to be charged to validate that decision; only monopolies can do that. For example, can a house owner demand that his rents be set by a rent tribunal on the basis that he should earn a normal return on replacement cost? Can the world's shipping owners overcome a depression in the shipping trade by demanding that some international tribunal award them charter rates to cover replacement costs?

The theory of capital that's implicit in this report is that capital is a malleable fund of J.B. Clark-type jelly capital which can be pulled in and out, but once it is sunk, it's sunk. There is another issue I think ought to be addressed in the question of road-pricing reform. I don't see how any can talk about user pays for road pricing and ignore fuel taxes. If user charges were to be imposed for road usage then obviously the fuel taxes would have to be abolished to eliminate double charging and, in this respect, the quality of the American roads built on a fairly modest petrol tax, notwithstanding differences in population size, compares more than favourably to the Australian situation where road taxes have implicitly been levied through fuel taxes and not spent on the appropriate roads.

The point I suppose I am making is that the report does not address the issue of externality; implicitly it is assumed away as though there is some sort of COSE-type world where externality can be negotiated away by private actors without any transactions costs. It assumes a concept of jelly capital which ignores quasi rents and the fact that sunk capital can't be retrieved and therefore there should be a critiquing of the pricing on replacement cost, which can be seen as a form of taxation of rural and regional Australia, and there is an implicit assumption that governments have to get a rate of return on money they spend on infrastructure but can throw it to the winds on current expenditure. Nobody has addressed that logical conundrum.

MR COSGROVE: Thanks, Terry. I think it needs to be understood that the purpose of this inquiry is not to rewrite the basis of agreements reached between governments. We have been asked to look at their effects and, insofar as we find adverse outcomes of those effects, to put forward suggestions for improving the situation. But without having understood all of what you have said, I must say - which is probably a weakness of my knowledge as compared with yours - I think some of the matters you are covering at least are probably not within the purview of our terms of reference.

DR DWYER: With due respect, Mr Chairman, the report rests on an implicit theoretical basis; that basis has to be exposed and understood and the use of the word "subsidisation" in the report has to be carefully analysed because, as an economist, you would have to say that somebody is not being subsidised if they're being taxed on the one hand and then receiving some of that back in the form of a subsidy on the other, so the very use of words in the report has to be very carefully analysed it seems to me.

MR COSGROVE: We will surely have a look at that.

MR BRAITHWAITE: I'm not an economist. That's an advantage in an argument like this. You talk about the beneficiary - it shouldn't be over the user but it should be over the beneficiary. Are you using "the beneficiary" very loosely to say government should be involved or should there be a further removal as far as that beneficial aspect is concerned?

DR DWYER: Let me put it this way: if you are going to talk about subsidisation - and I share the Productivity Commission's view, by the way, that people should not necessarily be subsidised and money thrown away, but you have first got to recognise what the situation will be in a zero tax world and it is not necessarily a neutral situation where you start with a tax system where treasuries expect to appropriate, for example, company income tax - 36 per cent of what is produced - yet contribute absolutely nothing to the infrastructure necessary to produce it. That is the first question. What I am saying is that the government itself is a major beneficiary of all infrastructure investment.

MR COSGROVE: Not government, the community. Governments raise taxation so they can meet various community needs.

DR DWYER: There is a lot of, I suppose, public choice theory that would go into there. The more cynical would suggest that governments raise money to buy votes - but, anyway, I am not going to get into that.

MR BRAITHWAITE: I think, to answer my question, you're basically using "the beneficiary" as being the government - a government getting taxes.

DR DWYER: The government is a beneficiary of private sector infrastructure investment and therefore should not expect to be able to benefit without contributing. But another point I would make is that implicitly there is no discussion for report about rural and regional Australia; there is no economic modelling of locational decisions underlying this report. If you think about infrastructure, infrastructure by definition is spatial. The people who benefit from it must be near it. A road raises the value of the adjacent land. Land-holders are often beneficiaries of infrastructure investment.

Actually in the Federal Court recently the Tax Office just won a case on this argument. It has basically said that when there is a real estate development that goes for 15 years the developer should not be able to write off the early costs of his infrastructure servicing the remaining blocks as and when he hands over title to a local government; he should write it off gradually because in fact the expenditure benefits the remaining blocks.

The point is that when money is spent on infrastructure it is not just the users who benefit but the adjacent land-holders. That was the argument being put forward by the proponents of the very fast train. So you have to think if you are going to think about pricing of public utilities and analyse it as a form of taxation or subsidy -

you have first got to establish what the efficient price is. Hotelling's argument and the argument traditionally employed by economists is that efficient pricing for public utilities is marginal cost pricing, and insofar as national competition policy by requiring a commercial rate of return on assets - means that rural and regional Australia is being charged above marginal cost and that should be seen as a tax on rural and regional Australia.

There is an implicit assumption, it seems to me, in a lot of discussion on this, that the efficient price is a mark-up over marginal cost necessary to recover the fixed costs of the infrastructure. And what I am suggesting is perhaps the fixed cost of the infrastructure should be met by governments or by beneficiaries such as adjacent land-holders to the infrastructure.

MR RITCHIE: I think we should add there that it is not just price, it is service as well. I mean, you can substitute the word "price" and "availability of equal service" in that discussion. As I mentioned in my report, we are not just talking about the price of infrastructure; we are talking about the service.

MR COSGROVE: It is very difficult to get solid information on service quality, as we have said in the report.

MR RITCHIE: Absolutely.

MR COSGROVE: But at least in the area of repairs to the telephone system it seems from statistics compiled by the Australian Communications Authority that the rural areas receive better service than the city areas do, and the remote areas do worse than both; in other words, not an unequivocal case that people in some parts - some important parts - of the country are less well served than those in the metropolitan centres.

MR RITCHIE: I probably should add that they are figures that we have some problems with and we don't want to go into them at this stage; we can certainly send them over to you.

MR COSGROVE: Yes, well, the ACA is an independent agency; we're assuming it is putting them together on a reasonable basis but, if you have other information, we would be happy to look at it.

MR RITCHIE: One example of the issues that Terry is alluding to is - and Bob knows more about this than me - transmission charges for gas pipelines. What is worrying rural and regional Australia is that we have tipped economic theory on its head and we're just going to end up with a whole series of banking situations that we have had in the 80s and 90s and all of the - - -

MR COSGROVE: It has got nothing to do with national competition policy.

MR RITCHIE: No, I know banking isn't, but it's a pro forma, or a role model for

what is going to happen in utility provision. Rural and regional Australia is quite rightly asking the question, "When my telegraph pole falls over who is going to come out and put it back up so that I get my electricity supply? Am I going to get the same telecommunication service as metropolitan Australia?" And if we adopt the model of user pays the answer is going to be no, and the answer is going to be no for all of the same reasons that the banking industry has justified closing rural bank branches; they are not efficient and they don't cover their costs. They are the questions that we're starting to ask and we want answers, and the only answer we ever get is that governments will provide them, either through adjustment payments or through community service obligations, and we are not seeing any of that.

MR COSGROVE: I think that is an overstatement. There are still very substantial community service obligations paid by governments in a number of areas for the specific benefit of people living in rural areas.

DR DWYER: That's the point - community service obligations are seen as a form of welfare and therefore liable to be taken away by treasuries as and when budgetary requirements allow them to do so.

MR COSGROVE: Taken away by the representatives of the people, I would say; not by treasuries.

DR DWYER: Treasuries, I think - let's get to the truth of the matter. But, seriously, let's look at it this way, if I can give you a crystal clear example of this problem of user pays versus beneficiary pays. Take the Sydney Harbour Bridge: when it was built - and you look at pictures of the Sydney Harbour Bridge. How many cars do you see on it? Just a half a dozen Ford model Ts plodding over the Sydney Harbour Bridge. The Sydney Harbour Bridge would never have been built if national competition policy principles had been applied to it in the 1920s. Now, in fact, the Sydney Harbour Bridge was built and part of the way it was financed was by a rate on both sides of the harbour. The governments of the day said, "The beneficiaries of this project are going to be the land-holders whose land values are going to be increased by this project," so, in a sense, acting as their representative agent - if we do believe that governments do sometimes do that - it basically said, "You'll contribute to the cost of a public work that will benefit you."

Imagine if the Sydney Harbour Bridge had been built and then the government had said, "We have invested X million pounds in this project. We think it owes us a rate of return. The price for driving your 10 model Ts on this a day will be 20,000 pounds each trip." I mean, it would have been an ultimate economic absurdity; the bridge would have been there, utterly unused.

MR COSGROVE: Yes, well, there was a public good characteristic in that case, Terry. I think it is different from some of the other areas of service provision, where it is easier to identify a specific group of beneficiaries. They may not always be solely the specific users of that particular piece of infrastructure but it is a different case from a road.

DR DWYER: Is it?

MR COSGROVE: I think it is.

MR BRAITHWAITE: That is what I am trying to come to grips with. I can understand the argument you are advancing on dams and roads - trying to get a cost recovery on that type of infrastructure - but when you come to electricity, because the market there is - the Victorian situation, they have privatised. You know, it wasn't a matter of asset valuation, it was what somebody was prepared to pay for it. In exactly the same way a power station can be sold. New South Wales was going to do it at the last election but the party didn't win power. So you are putting a value on it, quite apart from the valuation of assets, and the utility that buys it will be trying to get a cost recovery on their asset valuation as defined.

Now, that is what I am trying to come to grips with. What Bob has been saying about electricity and the sunken funds as against the dam and a sunken fund - I can understand a dam and a sunken fund but I can't see the point in a port authority, where the asset is going to be determined by a buyer with what they think they can make out of it, not on the asset valuation - and to the extent that a generation station is going to be determined by somebody who can get X number of dollars out of it - so could you just - - -

MR LIM: Perhaps I could explain that a bit. When I keep on referring to governments setting asset prices, you will find in the national electricity code that governments' jurisdictions, as they call them, have a right of actually setting the initial asset value for regulatory purposes. In other words, governments have every right under the national electricity code to say, "This is the value that regulators should look at and accept for regulatory purposes." That is the point which I think needs to be brought up, that in fact under the national competition policy or COAG-type arrangements, the preferred asset valuation methodology has been expressed as "deprival value", which is the replacement cost valuation. In other words, the COAG agreements actually say that the regulators have to accept deprival value for looking at the regulation of electricity.

So when I talk about government involvement in some of the competition policy reform areas the involvement or interventions have been very against the sort of lower price outcomes for those reasons. Another example on electricity, Ray, is that under national electricity code, the users have to pay for the use of transmission rather than, as Terry has been saying about beneficiaries paying for the use of a transmission - you know, the generators basically don't pay for the transmission, so if you are living in rural communities where you have to wield electricity over long distances and you have a cost allocation method according to distance as well as loss factors - because the further you wield electricity, the more loss factors there are - you end up paying a hell of a lot more for transmission prices, and I can leave some slides on transmission prices which vary quite significantly as between states.

MR COSGROVE: What is the indication of that, Bob? You seem to see that as the wrong approach, so what would you see as the better approach?

MR LIM: The right approach really should be that the people who benefit from the use of the wires should be paying for it.

MR COSGROVE: Who are they?

MR LIM: They should be the generators, the retailers, the distributors and the users.

MR COSGROVE: So you mean governments aren't charging the generators?

MR LIM: No, under the National Electricity Code the generators have got out of having to pay for the use of the transmission system because governments have been instrumental - - -

MR COSGROVE: Aren't they paying an access price?

MR LIM: They pay a connection charge, etcetera, but they don't pay like a producer of goods, delivering goods to the marketplace. The producer pays for delivering those goods to the marketplace, but in the electricity model that we have, the producer doesn't pay.

MR COSGROVE: Doesn't the consumer pay for the transportation costs of getting goods to the market?

MR LIM: No, the producer pays for getting the goods to the marketplace. There might be a charge placed on consumers, but essentially - - -

MR COSGROVE: Yes, but the incidence of the cost surely rests in the end with the consumers?

DR DWYER: No, not necessarily. You think of the commercial model: if I am selling across Australia and I have a recommended retail price for a book, it will be the same price for that book whether it's sold in Broome or anywhere else. In other words the competitive market, in a competitive world, does sometimes endorse postage stamp pricing.

MR LIM: Yes.

MR COSGROVE: Right, but that's not to say that the producers - - -

MR LIM: Who benefit.

MR COSGROVE: - - - are bearing the cost. What's happening in that case is, as

you said, postage stamp pricing: instead of individual groups of consumers paying more than other groups of consumers, all consumers are paying the same price. So some are paying more than they should, others are paying less than they should.

DR DWYER: What do you mean by "should" if that is what a competitive market dictates?

MR COSGROVE: Well, for the cost of delivering that product to them.

DR DWYER: But that's a market outcome, so isn't it efficient?

MR COSGROVE: Well, it may be judged so by the people producing that particular product, and that's a matter for them and their market.

DR DWYER: I think what Bob is pointing out is, that is the difference. In other words, you don't have that in the electricity case; you are not allowed to operate that way.

MR LIM: In the electricity case the users pay for the transmission of the electricity to their point of consumption.

MR COSGROVE: Yes. I think we may be talking in semantic terms, but I think the consumers are paying for the books as well, it's just that you have got postage stamp pricing in one case and not in the other.

DR DWYER: And not allowed in the other, I think is Bob's point.

MR COSGROVE: Not allowed?

DR DWYER: Because if you had a market situation maybe postage stamp pricing would be adopted as more efficient.

MR BRAITHWAITE: Surely it would depend on what the market is going to be for the product, too? A tomato grower in Bowen selling into the markets in Sydney has a price determined by the market on that day, and the cost of the transport is borne by the tomato farmer. In some cases, the costs are greater than the recovery. Also, selling into an export market, that determines the domestic price.

MR COSGROVE: I would like to come back to a few issues that Todd raised earlier on. We need to keep an eye on the clock as well. You mentioned, Todd, that there were some other areas - I don't think you identified them - which were not being subject to reform. Areas of policy, I took you to be referring to. It was earlier on in your remarks. Could you tell me what you had in mind.

MR RITCHIE: Areas such as labour markets, some of the professional areas that seem to have been exempt from NCP - although that has been rectified in some areas.

MR COSGROVE: Yes.

MR RITCHIE: We were talking about things such as wage conditions, particularly when you refer to abattoirs and the tally system.

MR COSGROVE: Yes - so mostly labour market.

MR RITCHIE: Yes, largely labour market, but certainly other areas and, as I said, particularly professional services that were, let's say, slow off the mark.

MR COSGROVE: Yes.

MR RITCHIE: It seemed that as soon as NCP started it went straight to rural and regional Australia, and that's where a lot of the reforms have been initiated and are most down the track. But when it comes to these professions and labour market practices, etcetera, we haven't heard anything about them.

MR COSGROVE: I think when you say it went first of all to rural and regional Australia, I'd say it's more correct to say it went first of all in the so-called related reforms, which began probably as early as 10 years ago, to major areas of infrastructure - rail, electricity and telecommunications in particular. Now, you would agree, surely, that they had significant effects in city areas as well as in country areas, and that there were benefits for both as well as costs for both?

MR RITCHIE: Yes, and certainly there were benefits to the city, and even your own figures show that most of those reforms are benefiting metropolitan Australia to a much greater extent than they are benefiting rural Australia.

MR COSGROVE: Yes, that's right, but there are some benefits for country areas as well as metropolitan.

DR DWYER: But in that sense Senator Boswell was not necessarily wrong in that remark that's quoted in the report when he said that competition policy is acting like a giant vacuum cleaner.

MR COSGROVE: We didn't say that he was wrong, we simply quoted him.

DR DWYER: Well, what's interesting is that if the benefits are differentially flowing to urban areas with compact sizes as opposed to rural and regional, there will be an economic effect; in effect, it's becoming cheaper to locate your business in the city than the country.

MR COSGROVE: That's the very area where we were seeking some guidance through this round of hearings. Is there anything that you can tell us about what has happened in terms of benefits and costs as a result of those infrastructure reforms? I am looking at particularly costs of these services, prices, and employment effects. We have talked a bit about service quality. You don't have any more on that?

MR RITCHIE: The short answer is that I did circulate to all of our members and I asked specifically for examples of benefits that have flowed. I haven't received a response. That's fairly typical of our organisation at the moment, because we are busy. But I should say that Bob and Terry are going to address some of these issues in the second part of their report, which hasn't been progressed yet.

MR COSGROVE: Yes. One other point you referred to, Todd, related to adjustment assistance. You were saying, "Where is the money?" I think budgetary documents would show that there is a fair bit of money changing hands. But we had raised again in our draft report some suggested approaches to the way in which adjustment assistance might be provided. Do you have any observations on those?

MR RITCHIE: When you say money has changed hands, it's changed from the Commonwealth to the states.

MR COSGROVE: No, it has changed from taxpayers to people who are receiving various forms of support.

MR RITCHIE: As a result of compensation for changes in national competition policy.

MR COSGROVE: In part, perhaps, but for change generally, yes.

MR RITCHIE: I can't think of one dollar that has flowed to anybody for adjustment assistance as a result of a national competition policy reform. I would say can anybody identify anybody who's received a single dollar from a state government earmarked as a compensation payment as part of an adjustment system?

MR COSGROVE: Why should it come from a state government?

MR RITCHIE: Because they are the ones who are receiving the compensation payments.

MR COSGROVE: Competition payments - yes.

MR RITCHIE: Competition payments.

MR COSGROVE: Which are not tied to the provision of adjustment assistance at all. And why would you want them to be?

MR RITCHIE: We can discuss whether they should be or not, but the thing is, whenever anybody goes into a public forum and defends competition policy they rest their case on two issues. They say, "Well, of course there are adjustment moneys available to be paid to anybody who's not benefiting or anybody who's had a cost as a result of national competition policy." In fact, that is the standard approach - - -

MR COSGROVE: Who is saying that?

MR RITCHIE: - - - from the National Competition Council. I think we could find many, many quotes from the National Competition Council on that issue, and I'd be happy to dig them out.

MR COSGROVE: Yes.

MR RITCHIE: The second thing they rest on - and I don't want to go back into infrastructure, because we've moved off it - is, "Well, let's charge every user his total efficient cost and then we'll go back into community service obligations." We think these are just blockades that they're hiding behind. The adjustment assistance isn't flowing and the community service obligations aren't flowing and we'll have to be fighting for those community service obligations in perpetuity.

MR COSGROVE: Yes. I think what I was really grasping for is, wherever you think this money should come from, and whoever you think it - well, not to whoever you think it should go to, that's part of my question - in what form would you suggest that adjustment assistance be provided, and to which particular groups of people or regions? These are some of the questions we've raised in the draft report. We have suggested, as you would have seen, that we think that for the most part the existing generally available adjustment assistance arrangements should be drawn upon, and they come mainly of course from the Commonwealth government - not entirely, but very largely. But we also thought that there might be some cases where more specific assistance to people particularly disadvantaged might need to be considered. Do you have any thoughts on those areas?

MR RITCHIE: I think, John, ultimately those decisions will be part of the political or government mental process in the state governments. All we're saying is that these transfers of funds - there should be a fund set up by all state governments and let's call it the adjustment assistance money fund or something simple like that; let's have it sitting there and then let's create a process whereby anybody who thinks they've been impacted by national competition policy can go to that fund. At the moment, the funds go straight into consolidated revenue and they're used on - these are funds directly as a result of adopting national competition policy, a very specific policy, and the money goes into general revenue.

MR COSGROVE: Yes.

MR RITCHIE: It should go into a specific fund - hypothecated, if you like.

DR DWYER: Actually if I may make a comment there, I think Todd has raised a very interesting political economy point, because people - I mean, I'm just looking at this from an economist's point of view and I don't particularly care about the politics of it, but people often wonder with puzzlement as to why there appears to be such hostility emerging in some sectors of the community in Australia to micro-economic reform and why it appears to have become a term of abuse - economic rationalism or

whatever - you see it popularly. I would suggest that maybe there is a political economy reason, if I can put it that way - is that people will support reform if those making the sacrifices get the rewards. But people would prefer a more inefficient system of cross-subsidisation if at least they get something out of it, rather than to become more efficient so the whole of the gains are appropriated by governments to be distributed on a means-tested basis to non-producers.

The point is, with subsidisation of the PMG - years pass - subsidisation of telephones - we may have had inferior services or we may have - but we, for example, often had cheap electricity. You look at Canberra homes and how poorly insulated they are. They reflect a time when governments spent money building generators and just pouring it in. The whole community got that. It may have been inefficient, but everybody got something out of it. If you're asking people to move to a more efficient situation and to bear higher costs in doing so, then they may say no if they see nothing coming their way out of it.

MR COSGROVE: Yes, well, I'm sure there are people who would take that view, and we could argue about this for a long time, but we don't have that time. But I can also see that most people like to have higher incomes year in, year out, and that maintaining inefficient systems is, on the whole, not a very good way of producing additional income.

DR DWYER: I quite agree with you, but the problem in this is that that is the political economy side. The other side, which is the positive economic side, is the question of what is the efficient price, and economic theory says marginal cost, not a mark-up over marginal cost. From Australia's long-term point of view, infrastructure becomes very important because we're competing against jurisdictions such as Hong Kong that are building projects like airports out of current revenue and not necessarily adopting user-pays philosophies on it.

MR COSGROVE: Yes.

MR RITCHIE: I should also add, John - and it's related to this sinking fund - the asset values set are supposed to also create a sinking fund for the ongoing provision of infrastructure. Now, where do we see that? How can we check that in company accounts? How do we know that the money and the asset prices that we seek on stock markets for some of these organisations reflects the fact that the companies and the people buying into the companies are thinking, "Well, that's just current revenue. This company itself isn't going to replace this infrastructure at some time in the future"?

MR LIM: Perhaps I could elaborate slightly on that, John?

MR COSGROVE: Yes, sure.

MR LIM: We have the system of regulatory reviews where prices are set for the use of whatever over a five-year period. The system has been that prices are set to

send the right signals for future investment. I guess what Todd is expressing is that there is no guarantee that the asset owner or the service provider will indeed, having received half prices to get the right sectors for new investment, in the third or the fourth year, actually put in the new investment. So in a sense there is that concern that future infrastructure may not be available given that sort of system, and perhaps the reference to the sinking fund might be that you actually have some surety, if you like, that some of the prices that consumers are paying for now will actually be devoted to providing that investment in the future.

MR COSGROVE: Are we talking here about private companies or publicly owned companies?

MR LIM: Private companies that are subject to the Hilmer and the access policy.

MR COSGROVE: I'm not sure what relevance that is to our particular inquiry here, but - - -

MR BRAITHWAITE: But certainly as far as government ownership is concerned I know that there is concern by those who have an interest in the water situation that the government should also provide annuities to a sinking fund where they provide the head waters, and the disbelief is that would a government actually put aside money in this year to be held there for the eventuality? I think there's reason for some doubts in that regard. But whatever you say about the system and the spread of competition payments, the system still allows a state like New South Wales to say, "We will not go ahead with the review of the rice industry and we will suffer a \$10 million deficiency out of the payments." So that is there, and I think Queensland might be looking at the same thing as far as dams are concerned, so there is the ability to do those things but at a penalty.

Could I just ask, on a labour market, in hindsight do you think there has been more achieved through the deregulation of a labour market being outside a national competition policy than having it inside?

MR RITCHIE: That's probably not an unreasonable proposition, although if we were to apply the same ruthlessness to the labour market as some of the national competition policy reforms we might get even more progress. But obviously the transfer of power there I don't think would be feasible because you would have a union system that wouldn't have signed up without a significant bribe. It would be difficult to imagine how you would bribe them.

MR BRAITHWAITE: No, I think we were all disturbed that it wasn't included in the first place but I think we're all starting to realise why it wasn't now.

MR COSGROVE: Todd, just one final question, if I may, because we need to move on to our next participant. Your members are operating largely in export markets where conditions are very competitive and markets sometimes are very badly distorted. I would have thought that therefore one of the real needs that they have is

to obtain access to more efficient costs of various inputs that they need, including better service in that area as well. That was undoubtedly, I would say, one of the intentions of NCP when the government introduced it but you seem to be saying to us that nothing much of that type has happened and, what's more, from what you were just saying about the ruthlessness of the process, you don't see it as somehow or other being possible.

MR RITCHIE: I think that's fair enough. I think your report has trouble finding concrete evidence of efficiency gains in rural and regional Australia. We can find concrete gains in adjoining coastal strips but it seems all the figures suggest the further you get from the coast the less the benefits are.

MR COSGROVE: As Bob was saying, that's usually because there's no competition. It's a little unreasonable to damn NCP where it's not taking any effect and effectively can't have any effect.

MR RITCHIE: It's reasonable to damn the process of NCP, and there are two other temporal elements to it. The first one is that NCP definitionally - and the figures indicate it - is going to favour metropolitan Australia. It comes back to the Boswell quote, and that's going to result in resource allocation away from Australia into metropolitan Australia.

MR COSGROVE: But that's happening for lots of reasons - and mainly for non-NCP reasons, we have concluded anyway. You may disagree with us on that.

MR RITCHIE: "Mainly" might be too strong a word.

MR COSGROVE: It's not something that began in the 1990s.

MR RITCHIE: No, but the second element that we're talking about is another temporal element, and we've already touched on it. Who is going to supply the infrastructure and who would want to supply infrastructure in rural and remote Australia? I mean if you take NCP to its - - -

MR COSGROVE: There's quite a bit of it being supplied - and we will come to this with our next participant - as a result of, for example, gas deregulation and some elements of NCP in that area. Major parts of remote Australia have gained significantly from that.

MR RITCHIE: That may be true.

DR DWYER: There generally will be cherry picking. I mean after all, Lyndon Johnson made his reputation as a congressman by electrifying West Texas. I mean the fact of the matter is - and it's generally recognised in the public utility pricing - the profits are found in the compact centres of a large population. A mile of wire servicing up to a hundred households is a much better proposition than a mile servicing one.

MR COSGROVE: You can't expect to build major electricity plants where the market for them doesn't exist.

MR RITCHIE: No, we can't expect that but we can expect people, no matter where they live, to have reasonable access to a reasonable service at roughly the same price as metropolitan areas.

MR COSGROVE: Despite the cost of provision?

MR RITCHIE: Absolutely.

DR DWYER: The point is as long as the price charged to the consumer is above marginal cost, that's efficient. The real question we're talking about is recovering the fixed costs of the infrastructure, the sunk costs, and that's where the economic theory is so important and that's where the differences between city and country were so great. Because as people know from the US experience, and everywhere else, your urban electrification or urban water or sewerage can probably be undertaken by a private developer without being able to recapture externalities because he has got the density of demand, but when it comes to networks over a wide spatial area it's a different proposition.

That's particularly important for this country which is not a compact city state like Singapore or Hong Kong. It's a continent inhabited by a population less than half the size of California competing against the United States which is densely populated and has an excellent highway and transport system linked with many thickly settled parts of the country. So in that sense, if we're going to be competitive, all these things matter a great deal.

MR COSGROVE: They do and that was one of the reasons why I asked my question about the intended effects of NCP.

MR BRAITHWAITE: Just to nominate the infrastructure that you feel should be available with the beneficiaries assistance in the bush - water, roads, rail to the extent they service the outback, electricity to the extent they service the outback - Telstra I think with the \$1 billion deal that's coming up ought to satisfy a lot of the problems on that area - are there any others?

DR DWYER: That's plenty. Basically all forms of network spatially linked infrastructure.

MR RITCHIE: We have always argued that community service obligations exist in a much wider range of facilities than the government will admit. In fact we have argued before the senate that there is a community service obligation characteristic to banking. We haven't got that far on that one but that's the position we have. Where you draw the line is very difficult but why draw the line? If it has got some element of essentiality then it should be included in the package.

MR LIM: Mr Chairman, if I could just add a footnote to Ray's comments, you will probably find in the case of electricity the National Electricity Court Administrator has come up with a final report on its review of transmission and distribution network pricing that actually says that for sunk investments users should continue to pay for the transmission system, but for new investments after 2000 or something like that beneficiaries should pay. So in a sense they are actually accepting the economic argument that beneficiaries should pay for the use of a system. But in the case of the existing assets, because governments are seeking to privatise their generators, and if the generators are not put into their saddlebags, the fact that they have to pay for the bulk of the transmission system, they will fetch a better price.

The governments have been able to put the pressure on the National Electricity Court Administrator to actually have a dual system of users paying for the sunk assets and beneficiaries paying for the new assets, so in fact you have two classes of generators being created as well. Here are some of the detailed problems of some of the outworkings of national competition policy which, with all due respect, chairman, have departed quite some distance from the original Hilmer intentions. That was why I was emphasising the Hilmer benchmarks.

MR COSGROVE: Yes. Thanks very much for coming along and we will be reviewing the transcript of your remarks.

MR COSGROVE: Our next participant is the Grains Council of Australia. Would you please introduce yourself for our transcript recording, please, and indicate the capacities in which you are with us today.

MR KREITALS: My name is John Kreitals. I'm the deputy director of the Grains Council of Australia.

MR SPENCER: I am Leigh Spencer and I'm the research officer from the Grains Council of Australia.

MR COSGROVE: Thank you, and thank you for your earlier submission to us, which is appreciated.

MR KREITALS: Thank you too for giving us the opportunity to talk about our submission. We have a second submission which we will pass to you at the conclusion which comments on recommendations that have been made. What I would like to do today is basically go through our two submissions in summary form. I would like to outline what the GCA is, reiterate on our recommendations in our first submission and have a look at your recommendations, recommendations 1 to 9, and make some comments on those, and if there are some questions then we're happy to answer those.

The Grains Council of Australia is the peak policy body for the Australian grains industry and we represent some 60,000 grain growers. Our members are the farmer organisation in each state, the New South Wales Farmers, etcetera. The council has had a keen interest in the national competition policy because of what benefits the grains industry and the wider community can achieve from a more efficient Australian economy. However, we are concerned that the fundamental objective of NCP - that is that competition can enhance community welfare because of its positive impact on economic efficiency and other social goals - may be overlooked in the implementation process. So the council welcomes this opportunity to place our views before the commission.

Our earlier submission argued that a key determinant of the impact on national competition policy on rural and regional Australia and with the effect of NCP policy measures on the international competitiveness of the Australian industry - and I emphasise on the international competitiveness - it should not be assumed that increasing competition will under all circumstances be of benefit to the Australian community.

In the first instance NCP reviews must take account of the fact that competition can be derived from either national or domestic competition, and in the case of the grains industry we continue to emphasise the international competition aspects because it is of particular importance to the grains industry because we are the largest primary producer. We produce a quarter of the GVP of the farm sector and 80 per cent of our production is exported into international markets. So GCA is concerned that without a full consideration under any NCP review of the impacts that

there could be disproportionate impacts on the rural and regional Australia.

GCA is asking that when assessment is made during NCP reviews the net aggregate community welfare accruing from increased competition should also take into account the geographical distribution of the benefits and costs. For those communities bearing the cost of any change an assessment also needs to be made of their ability to adjust. I might just briefly go through our earlier recommendations and then I will make some comment on how they fit in with the Productivity Commission's recommendations.

Our recommendations were that the governments ensure that national competition policy is not implemented without reference to the core objective of enhancing community welfare by way of a positive impact on economic efficiency and - and I emphasise this - other social goals. In undertaking the review for the purpose for which this arrangement was designed to take into consideration - and further subsequent reviews are not undertaken according to any arbitrary timetable but are undertaken when the situation, to which the anticompetitive arrangement is directed, has materially altered. I will come back to that later because that is one of your recommendations in terms of the timetable.

A further recommendation of the council is that a distinction is made between arrangements to restrict competition and operate in an international context and arrangements which restrict competition and operate predominantly in a domestic context. A further recommendation is that arrangements established to assist agricultural producers, designed to address international market failure, should not be dismantled without due consideration of the effects of such an action on Australia's rural and regional communities. For those communities bearing the cost of any change, an assessment is made of their ability to adjust the alternative opportunities available to the necessity for relevant governments to provide appropriate adjustment systems. And again I will make some reference to this when I go through your recommendations.

The final two recommendations of the Grains Council were that any analysis of an anticompetitive arrangement takes full account of the complexities of the relationship between supplier and consumer, and comparisons should take into account not only price but also other often less quantifiable benefits such as service and quality. They are our recommendations.

If I turn to recommendations 1 to 9 of the Productivity Commission, I think the Grains Council overall would support the nine recommendations; certainly we support the philosophy beneath those recommendations. However, we do have some comments on those, particularly those relating to recommendations 4, 6 and 9. I will briefly touch on those and make some comment, and then I will ask Leigh if he wants to further expand on those. He might like to do that.

Recommendation 4 relates to the benefits and costs for Australia to be considered. As I said, GCA supports that but GCA also believes that the regional

distribution of those benefits and costs also needs to be taken into consideration. Further, that for those communities bearing the costs of any change, an assessment needs to be made of their ability to adjust.

Recommendation 6 of the Productivity Commission relates to having no extension in the NCP timetable. Whilst the GCA understands the rationale behind this, the GCA points out that anticompetitive arrangements have been put in place to deal with a particular situation, and thus the time to review those arrangements is when the nature of the situation has substantially altered rather than necessarily sticking to a timetable for the sake of sticking to a timetable.

Recommendation 9 of the Productivity Commission report relates to government assistance, being generally available measures. Whilst again the GCA understands the logic behind the recommendation, the GCA notes that there may be situations in which genuine available assistance measures are not suitable or adequate for dealing with the problems of the particular community that will be adversely affected by the NCP reforms. And thus the GCA believes that it is extremely important that NCP reviews take into consideration the need for appropriate targeted adjustment assistance. Thank you, at that I'll leave it and ask Leigh if he has any points.

MR SPENCER: Thanks, Jock. I just back up a couple of those things that Jock has already made and just mention a few points in regard to that perhaps in a little more depth. But I note that the Grains Council's position is basically that we are supportive of national competition policy as a concept. We do believe that there are benefits to be achieved as far as the Australian community generally, and rural and regional Australia, is concerned, coming out of NCP reforms. We think that some of those benefits have already been seen and already been delivered but another point to note there is that many of those benefits are still to come.

NCP is basically a concept in its implementation that is still relatively new. The competition principles agreement has only been in place for four or five years or so, and I think no-one suggested at the point that it was put into place that all the benefits coming out under of national competition policy would come about immediately. So we feel that there are still a lot of benefits to flow out of NCP, and perhaps that's something that the general community is not aware of and needs to be made more aware of, that NCP is an ongoing process, it is a long-term thing and the benefits are long-term benefits.

At the same time, I would reiterate Jock's point that we think it's important that the community is made aware and those involved in the implementation and enforcement of national competition policy are aware that national competition policy is not about pursuing competition for its own sake, it's about pursuing competition as a means to an end with that end being the objective of improving overall community welfare. In line with that, I would reiterate a couple of those things that Jock has already mentioned, particularly with regard to the fact that there are certainly situations where national competition policy can be said to benefit the

community overall but perhaps the benefits are disproportionate or there may even be costs that

come out of the reforms that go towards particular groups within the community, including those within rural and regional Australia, of bearing those costs.

The Grains Council's position is basically that those groups and the consideration of those groups and stakeholders should be taken into account when NCP is implemented, and when it comes to things like NCP reviews, the pieces of legislation, for example, recommendations coming out of those reviews should take account of the particular cost that may be placed on individual groups and appropriate adjustment assistance should be allowed to take account of those particular costs.

MR COSGROVE: Thank you. I wonder if we could start with that point you were just raising: the so-called public interest provisions. The competition principles agreement does set out a number of factors which are to be taken into account in particular when you are reviewing anticompetitive legislation, for example, but in other areas as well. Regional development, for example, is mentioned; social welfare and equity considerations, as well as environmental and other matters. In your experience with some of those reviews would you say that those factors have not been taken into account properly?

MR SPENCER: I do not know that I would so much go to the point of saying that they perhaps haven't been taken into account or that review panels have at least not tried to take them into account. But I think where a problem probably arises is that there is a bit of lack of understanding in the community generally as to just what is involved in the public interest provisions, what they're meant to achieve, etcetera, how they fit into the NCP process. As a consequence I think you get a situation where many industry stakeholders don't really understand them and as a consequence they don't know how to get across their particular interest to NCP review panels and how those interests may fit in under the concept of public interest.

As far as the CPA is concerned, there are those various factors that are set out but there is no actual definition of public interest or anything like that. Maybe that is a good thing because that allows it to be left fairly open, so that anything that could potentially be seen as a public interest is allowed to be taken into account. We also know that there is some guidance as far as other mechanisms are concerned in terms of trying to give stakeholders an idea of what may come under those public interest provisions.

For example, there is the concept which is related, of public benefit in the Trade Practices Act in the authorisation provisions, and there is a lot of ACCC authorisation decisions out there where various things have been taken account of as public benefits and those can be looked at by the stakeholders to say, "Well, this is the sort of thing that could also come into account under the public interest provisions as far as NCP reviews are concerned." Of course there are also appeals to the Competition Tribunal as far as those authorisation decisions and other elements that have been taken into account as far as public benefits are concerned there.

But my opinion is that the real problem, as I said earlier, does arise in the basis

of a lack of understanding in the community about how to use those public interest provisions. As a consequence the Grains Council is quite supportive of that recommendation number 2 in the Productivity Commission's report, that there is a need to put some guidelines out and actually give stakeholders an opportunity see what is likely to be taken into account as far as public interest is concerned and how they can utilise those public interest criteria to get their own positions across and get them taken into account.

MR BRAITHWAITE: Leigh, would you say that the public interest test is now being exercised a lot better than it was initially and with more understanding by the bureaucrats involved and the people concerned? Is it a better process now than what it was?

MR SPENCER: Yes, I think there is more understanding and it probably is the sort of thing that is starting to work better, and I guess you would expect that, in that when national competition policy first became something that was having an effect on people in the community generally it was a very new thing and no-one really knew how it was going to operate. Now you have got a circumstance where there have been quite a significant number of NCP reviews conducted into various areas of the economy and people have had an opportunity to see how those public interest provisions are being taken into account in those views.

Also there is a body of precedent being built up in terms of someone preparing, for example, for an NCP review coming up, having the opportunity now to look back at a whole series of other reviews that have been conducted; see the processes that were followed and how public interest was taken into account, whereas they really didn't have that opportunity when NCP reviews were first being established.

MR KREITALS: Perhaps I might just add that whilst the question originally from the chairman was in terms of past reviews, I guess from the Grains Council's point of view what we are concerned with is that reviews do take into account the full range of factors, and I am not too sure that has been done in the past; secondly, that an attempt is made to quantify all these factors, because often these things are difficult to quantify and because they are difficult to quantify they're sometimes ignored. I have no remedies of how they might be quantified but I think an attempt does have to be made that only the easy bits that are readily quantifiable - and that's usually the benefits - that seems to be done, and we forget about some of the cost. What we're saying is that we want to take into account the whole range of things and an attempt is made to quantify them.

MR COSGROVE: In the reviews of which you have experience could you provide us with any examples where you feel costs have not been adequately taken account of?

MR KREITALS: I said that I wasn't responding to your question in terms of - you were asking it in terms of what evidence; rather, we're looking to the future and saying that's the way it should be.

MR COSGROVE: So would you say you have not come across cases where that particular problem of recognising costs has occurred?

MR KREITALS: I couldn't comment on that but that's not to say that there hasn't been a problem. I'm just saying that I'm not in a position to indicate that problem.

MR COSGROVE: Some people have said to us that they've had difficulty even in obtaining - at least easily, if not at all - the terms of reference for a particular legislative review, and we've certainly heard on a number of occasions that the results of those reviews - you know, the reports themselves provided to governments - have not been made public. Again in the case of the reviews of statutory marketing arrangements that interest you people, has that been an issue or not? I would imagine probably not in your case.

MR SPENCER: No, I would probably say not. As it is, there has actually been one review of an organisation in our area that has been completed; you know, gone all the way through of having a review conducted, report, recommendations, the recommendations acted on.

MR COSGROVE: Which one is that?

MR SPENCER: That's the Australian Barley Board which is now ABB Grain Ltd. It has recently been privatised. What came out of that review was basically that single desk arrangements as far as export activities for ABB were extended until June 2001. We don't know what is going to happen after June 2001, whether they will be extended further or not.

MR COSGROVE: That particular report became a public document?

MR SPENCER: It certainly did, yes. But that is the only one that has actually been completed to a final situation.

MR COSGROVE: I was going to say, could you give us an update on what remains to be reviewed?

MR SPENCER: Yes. Basically I guess the major one is the New South Wales Grains Board. There has actually been a review conducted, set up by the New South Wales government. They conducted hearings late last year. We believe the report has been completed and presented to the New South Wales government but the government hasn't, as yet, released the report. That may be an issue as to when it's released and how available it is made, etcetera, but it's only something that has been completed in the last three or four months so it's obviously something that we're waiting on.

The Grain Pool of Western Australia is undergoing a review at the moment. It is a review that has been set up by Agriculture Western Australia. They are currently

accepting submissions in relation to that review and I think they close at the end of the month. The other main one is AWB Ltd and that is the large one as far as this industry is concerned because it is by far the largest entity operating in the grains industry. The initial timetable was that the review was supposed to be conducted this year but we believe that has now been put back and it looks as if it's going to start probably around March of next year.

MR COSGROVE: That's a Commonwealth review, is it?

MR SPENCER: It is, yes, and that is the big review that this organisation is looking forward to.

MR BRAITHWAITE: But you do have a single export facility until what year?

MR SPENCER: At the moment it's ongoing and that is something that's going to be a part of the review.

MR BRAITHWAITE: So there is no sunset on that.

MR SPENCER: There isn't.

MR COSGROVE: Thank you. In your original submission to us, you emphasise the need for higher cost efficiency in the provision of a number of things that your members have to use to produce; like transport, various farm inputs, including things like grain marketing and handling. Have you seen any effects of the national competition policy reforms in that particular area of input costs, either adverse or favourable? I was thinking of areas like, in particular, some of the big infrastructure costs like power or telecommunications, transport.

MR SPENCER: I think there have been some benefits in some of those areas as far as some of our members are concerned and, as I mentioned earlier, we certainly are aware that NCP is a process in which there are benefits that are going to come out of it and we think those benefits are likely, at least to some extent, to go to rural and regional Australia as well as to the cities.

MR COSGROVE: Where would you see them eventually flowing to the grain producers in this case? If we take a long-term view - - -

MR SPENCER: Sorry, did you say "when"?

MR COSGROVE: No, what type of areas of cost would you see as improving?

MR SPENCER: We would feel that there probably already have been benefits as far as things like transport provision and that sort of thing is concerned; improvements in terms of rail service and rail infrastructure, etcetera; probably improvements in terms of things like road transport as well.

MR BRAITHWAITE: What about ports?

MR SPENCER: And ports, yes. I haven't actually seen any figures with regard to it but I think that the efficiency of grain terminal facilities and handling facilities at the ports has improved in the recent period. Whether that is completely to do with NCP or whether there are other factors at work there as well, I'm not sure, but I reiterate the point that I made earlier basically that we tend to feel that there have been some benefits that have flowed to our stakeholders so far but we also feel that we are aware that NCP is a very new thing and a very young thing and we feel that a lot of those benefits are probably yet to come but we think there are certainly greater efficiencies that will be achieved in those areas in the future and that they will flow back to our stakeholders.

MR COSGROVE: The other point you raised which I am interested in is this question I think Jock raised about assessing the capacity of people to adjust to reforms and perhaps also other sources of change and the possible need for adjustment assistance. I think you were saying that while you don't disagree with the idea of generally available assistance being used, there may be some circumstances in which more specific targeted assistance would be needed. Could you tell us what sort of circumstances you have in mind?

MR KREITALS: That's a somewhat difficult hypothetical one because I think we really need to know the situation which we're talking about and that is, I guess, part of the reason why I'm saying I don't think we can rely on just general assistance because, depending on what the circumstances are, it may well be seen that general assistance doesn't meet the needs and so it's almost a chicken and egg argument, that one. I think one would have to - - -

MR COSGROVE: I think in our draft report we set out some guidance here. I will just try and locate it. We have a finding here which says:

There may be a case for specific adjustment assistance packages where a concentrated adjustment shock occurs rapidly and is large relative to the size of a community.

Does that make any sense to you? Are there any other observations you're able to provide us with to help us?

MR SPENCER: I guess our point really would be to say that we tend to feel that perhaps not all NCP reviews but most NCP reviews are basically different in that you're looking at a particular piece of legislation. In our case it's looking at statutory marketing authorities and saying it sets up a particular body that operates in a certain area and has particular powers and operates in a very specific manner and that the reforms that are coming out of NCP tend to vary depending on what sort of reviews are being conducted, what you're looking at, that sort of thing. As a consequence, the bottom line is that we tend to feel that these things need to be assessed on a case-by-case basis and that that means that the type of adjustment assistance that is

appropriate in a particular case is going to vary and could vary considerably depending on what that actual NCP review is.

MR COSGROVE: Would you see the assistance as being provided to all those subject to a review, whether or not all of them were actually likely to experience significant costs as a result of the review? I mean, there may be some farmers, for example, who can cope with a certain change; others who can't. If I can generalise that question somewhat, should this type of assistance be provided to individuals or to a region or members of an industry?

MR SPENCER: I guess our point would be to say that the most important thing is that the assistance is provided to those who are actually suffering from the reviews, that are actually being treated in some sort of disproportionate manner, and whether that needs to be across the board or whether it needs to be sort of focused more specifically in any particular manner really needs to be looked at on a case by case basis, depending on the review and the effects that are going to come out of particular NCP reforms. So I don't think there's a sort of catch-all or one answer to that question.

MR BRAITHWAITE: On pages 8 and 9 of your report you talk in terms of the situation of subsidies and overseas markets, by their producers; that's the price of barley and, I think, the price of flour. What message is in that comment that you made there for us looking at the NCP? Is that a very direct reference to the fact that you want a single-desk seller and that's it? What is the reference?

MR SPENCER: Basically what we're trying to say there - and I guess this comes back to - it's focused a little more widely perhaps than just looking at competition policy things because we're also getting a little bit into the area of trade policy there as well. But a concern that the Grains Council has had - and this is something that we have actually reiterated quite often as we get closer to the WTA negotiations later in the year - is that there seems to be a bit of a focus on saying that state trading enterprises or statutory marketing authorities are, in some way, trade distorting.

Our argument in that sort of forum, and we're presenting it here as having impact, I suppose, as far as NCP reforms are concerned as well, has been to say, "Well, our exporters in this area, in the grains area, are operating in a world market that's extremely distorted already because you have got this situation whereby you have got EU subsidies operating on a very significant level; you've got other countries subsidising their exports of grain as well; and you have also got the USA engaging in various trade-distorting policies as well, such as using credit arrangements on uncommercial terms in various markets, etcetera."

We feel that the operation of the single desks, as far as particularly AWB Ltd is concerned as a single-desk seller of wheat, gives them certain advantages in terms of market power on international markets in terms of size, in terms of efficiencies and economies of scale that allow them to compete more effectively in those markets that are already trade-distorted by the actions of other countries, basically.

MR BRAITHWAITE: That's one comment. You then go on to mention the barley, in particular. Are you saying a state-based single-desk power; is that power for domestic as well as export?

MR SPENCER: It has been in the past but basically there are different operators operating in each state as far as barley sales are concerned. Generally in the past they have had single-desk powers domestically as well as on export markets but that's moving through a reform process now. The Barley Board, for example, has lost their single-desk power on domestic markets. As I mentioned, those other state-based statutory marketing authorities are currently going through NCP review processes. I think there's a general assumption that the outcome of those will be that the remaining single-desk powers domestically will be lost as a consequence of that and that our focus has certainly been on what the outcome is going to be on the international markets as far as their export powers are concerned.

MR COSGROVE: Why is it that the legislative backing behind the single market selling into foreign markets is seen as so important? If growers perceive that they gained from operating collectively in international markets, wouldn't they want to do that anyway and why is the legislation necessary?

MR SPENCER: We think the legislation is necessary basically because of the extra element of certainty that it gives to the arrangements that are in place at the moment. I mean, one is aware that there are potential other arrangements, I guess, that could be put in place to try and achieve the same outcome.

MR COSGROVE: A cooperative, yes.

MR SPENCER: A cooperative, another thing that's - and, for example, what has often been talked about is the possibility of removing the legislation and allowing any new arrangements to be authorised by the ACCC, for example, under Part VII of the Trade Practices Act. We see some problems with that in terms of the loss of certainty that that would give to the industry generally. An ACCC authorisation is a whole new process that has to be gone through. A new assessment of public benefits has to be made within that process. Usually authorisations are for a limited time only - three years, five years, whatever it happens to be - with no certainty of what is going to happen after that.

There is also potential for the ACCC to revoke that authorisation whenever there is a material change of circumstance and there is some confusion as to exactly what constitutes a material change of circumstance. Then the final point, I guess, is to say that authorisation decisions are also appealable to the competition tribunal and, of course, that can be a very lengthy and very uncertain process.

MR COSGROVE: This is probably a difficult question but again, the impression from your earlier submission that you were seeing the likelihood of some significant adverse effects for your members if the review resulted in the abolition of the

statutory single-desk power; are you able to give us any feel for the likely size of that adverse effect? As you say, there are a number of other market developments occurring. Commodity prices are notoriously volatile, for a number of reasons, including government interventions. Has your organisation undertaken any work to indicate what you see as the value, let's say over a five-year period, of this particular piece of legislation?

MR SPENCER: I can't actually give you an answer on that one at the moment but we're a very large Australian industry and we think that quite a significant amount of the benefit that this industry brings to the Australian community rests on things like the current marketing arrangements that we have in place. That's our belief. As it is, we haven't gone down the road of actually putting figures and quantifying the extent of that benefit as yet, but it's something we're about to embark on, because we've got this review of AWB Ltd coming up next year and I know that AWB Ltd themselves are also working on putting figures on that. So it's not something I can give you an answer on now, but probably in four or five months' time.

MR KREITALS: There has been some historical work done on that. I think the most recent figures are probably about five years ago, but if you like we can take it on notice that we could extrapolate those numbers and get a five-year value on that, if you'd like. But we'd have to take it on notice.

MR COSGROVE: If you could. I'm afraid our own timetable now is not a very comfortable one and we'd probably need something in the next few weeks, I think, if we were to be able to make use of it.

MR SPENCER: We could come up with something indicative in a few weeks, I think, yes.

MR COSGROVE: Okay.

MR BRAITHWAITE: On the public interest test, we had one of the witnesses say that the public interest test should look beyond the effect on the producer and the consumer and it should have also the ability to look at the processor and the retailer in the middle of that chain. Have you got a view on that and how it might be accomplished?

MR SPENCER: I guess I'd just repeat the point I made earlier, which was in relation to talking about the scope of the public interest test and I was saying I do think there are advantages in terms of having more certainty there and guidelines and that sort of thing. But a big reason why there is no actual definition of public interest in the competition principles agreement and why there's no definition of public benefit in the Trade Practices Act, for example, though there are sets of criteria set out and that sort of thing - but there's no all-encompassing definition - is that basically anything could potentially be something that contributes to the public interest.

I think the idea of leaving it in that manner was to allow any stakeholders,

whoever they happen to be, to come forward and argue to an NCP review committee, "Well, there's a public interest involved here and this is why there's a public interest and we can put some figures on it, we can give you some quantification or whatever." Then it's really up to the NCP review panel to decide whether they actually think that is something that is coming out of the particular thing that they're looking at or that they're reviewing and whether it should be taken into account as a consequence. So I think it's important that it needs to be left open so that anything can be taken into account.

MR BRAITHWAITE: So what you're saying is that process would not be precluded under the current public interest test?

MR SPENCER: I don't think so, no. But I guess the only additional point is to say, no, perhaps it's not precluded, but perhaps it's constrained to some extent by the lack of understanding as far as the general community's awareness of what actually is meant by public interest and what should be taken into account under public interest is concerned.

MR COSGROVE: Certainly the public interest clause in the competition principles agreement points out that the factors which it does mention are not to be taken as exhaustive.

MR SPENCER: As exhaustive, yes.

MR COSGROVE: Just one question. I certainly don't understand what might be in place in this area and you may be able to help me, and that concerns grains handling. I thought there had already been some deregulation, at least in some states. I'm not sure whether it's a state-based arrangement or a federal one. Do you know if that is the case and, if so, what the effects of that have been on your members?

MR SPENCER: Yes, Jock might know more about that than me, perhaps.

MR KREITALS: Yes, there has been some. I think it's early days yet as to what those benefits might be, because I think we're just seeing some of the investments taking place at the moment. So what the benefits might be, I think it's probably a bit early to gauge.

MR SPENCER: It is. It's certainly an area of very significant activity at the moment and we suspect it's going to be more so in the future. There is continual talk of new investments in new areas, different companies entering into various states to compete against what has been traditionally been a single bulk handler. Basically, each state has traditionally had a single bulk handler.

MR COSGROVE: That's what I thought, yes - each state, I see.

MR SPENCER: It has, yes, but it's becoming increasingly competitive. For example, there's an AWB Ltd proposal to invest in storage and handling facilities in

Victoria in competition to VicGrain Ltd. There's also a couple of proposals involving Grain Co, which is the Queensland-based storage and handling provider, to invest in other states. Grain Co has already actually got some investments in Victoria. They're proposing to expand those and I believe they're also proposing to enter the storage and handling market in New South Wales as well.

But there are continual articles in the press, if one follows these things, suggesting possibilities of mergers and joint ventures and rationalisations, etcetera, involving all of these organisations, which wasn't really happening two or three years ago. The competitive pressures seem to be forcing these organisation to go down that route now and we're certainly expecting that. It's going to be something that will become much more significant in the fairly near future.

MR COSGROVE: Was there a substantial debate before the deregulation about its likely effects as much as we see in the case of the single desk issue? In other words, were people worried that a more freely operating market would have somehow or other disadvantaged them?

MR SPENCER: I think they were definitely worried. Now, I must admit I wasn't actually in the grains industry at the time this debate was going on. They certainly were worried. I'm not sure that it extended much beyond that in terms of people coming up with significant reasons as to why it shouldn't happen.

MR COSGROVE: But it's still too early, you would say, to ascertain its effects, would you?

MR SPENCER: I think it is, because as I mentioned, while there certainly is considerable pressure as far as these storage and handling organisations are concerned for them to rationalise and for them to enter into mergers and this sort of thing, none of it has actually really happened as yet. They're all proposals that are on the table.

MR COSGROVE: We don't have any further questions. Have you any other points you wanted to register with us?

MR SPENCER: No, I think that's pretty well it.

MR COSGROVE: Thank you very much for coming along and helping us. We'll take a break for lunch now and resume at 2 pm.

(Luncheon adjournment)

MR COSGROVE: Our next participants are the Australian Gas Association and the Australian Pipeline Industry Association. Could each of you please identify yourselves for the transcript and indicate the capacity in which you are with us.

MR EVANS: Mr Greg Evans, policy manager, Australian Gas Association.

DR BEASLEY: Dr Allen Beasley, executive director of the Australian Pipeline Industry Association.

MR COSGROVE: Thank you. What would you like to tell us.

MR EVANS: Thank you, commissioner. We thought we might both make opening statements and then receive any questions you might have.

MR COSGROVE: That's fine.

MR EVANS: Thank you for the opportunity today, commissioner. With respect to the report, the AGA supports the overall direction of the Productivity Commission in the draft report and notes the positive impact the national competition policy can have for economic growth across Australia. We agree that some adverse economic effects occurring in regional Australia are the result of deeper structural changes rather than the application of national competition policy.

Specific to the gas industry, AGA welcomes the opportunity to make the following points. National competition policy reforms have the potential to deliver positive economic outcomes for natural gas development in regional Australia. The regional and natural gas pipeline infrastructure developed through the late 80s and early 90s has aided delivering economic and environmental benefits to regional communities, including those facing declining services in other areas. To provide some context for the sector, gas is growing as a growing source of energy with we're estimating the gas consumption will grow by 4.3 per cent per annum up to the year 2015. The gas share of primary energy needs will grow to 28.9 per cent over the period from the current level of around 18 per cent.

Critical to these growth projections are potential international development such as the Papua New Guinea to Queensland gas pipeline. Investment in gas pipelines between now and 2005 is in the order of \$6 billion with total gas infrastructure development worth up to 14 billion over the same period. Against this background it's important that the regulatory process fosters its growth while delivering a competitive marketplace. Gas infrastructure brings jobs and investment, not only in its construction phase but it also provides an energy source for industrial and residential use, bringing with it greenfield investment opportunities and improving quality of life to product consumers.

While real and significant price reductions have been delivered by the industry to both industrial and private consumers, perhaps the bigger impact of gas

infrastructure development is the extension of pipelines to previously unserved areas, including interconnect arrangements across state borders. A positive competitive outcome for this process is supply competition between basins. The availability of gas can and does provide an economical energy source to encourage employment-stimulating activities in regional Australia, including mineral processing, abattoirs, paper mills, canneries, bakeries, etcetera.

While we support the overall competitive architecture of the reform process, our submission made three specific points. First, the economic regulators must allow adequate rates of return to encourage the further expansion investment in pipeline infrastructure. This would help underpin basin-to-basin competition. Secondly, competition could be enhanced by increasing the degree of regulatory certainty in the application of the national gas access code which adds to compliance costs and, to date, those costs have largely been absorbed by the industry. Thirdly, delays in approval processes, particularly at a state level for pipelines, mitigate the early access to the benefits of gas pipelines for users in regional Australia.

COAG's 1994 commitment to free and fair trade was an important impetus to the interstate trading of gas. It is not clear, however, that the adoption of the national access code as part of the national competition policy has contributed to a growing gas market. In fact many pipeline development plans predated the reform process. More broadly, various gas projects have proceeded on merit due to factors including environmental benefits, supply availability and the lowered costs of pipeline construction. AGA does however acknowledge the benefits which may flow from an efficiently administered third-party access regime for transmission and distribution pipelines.

As to the way forward, AGA considers that in order to lock in the full benefits that can flow to the gas industry from national competition policy, we must firstly increase competition between producers; secondly, streamline the access regime; thirdly, improve the approval process at state level; and fourthly and finally, reduce the uncertainty in relation to allowable rates of return on new pipeline developments. Thank you.

MR COSGROVE: Thanks, Greg. Yes.

DR BEASLEY: Thank you. While certainly APIA strongly supports the thrust of my colleague's comments, we would like to reinforce a couple of points relating in particular to the approvals process; secondly, relating to the importance of research and development in relation to a new pipeline development into regional Australia; and finally, the importance of producer competition as a means of driving the end result of price the customers see.

Quite clearly, COAG's 94 commitment to free and fair trade has had a very dramatic effect on the pipeline industry. It has led to major new developments and has opened a way for a whole range of new players looking at a whole range of new markets. The privatisation agenda has also assisted that particular outcome with new

players extending their reach across Australia as well as Australian-based companies looking at different markets. So the traditional state-based mentality where a resource was developed within a state and for a state has been very much overturned with a far more national approach to pipeline development. We see that in the whole spectrum of new pipeline developments and pipeline development companies who are operational in this country today.

I'd certainly support the comment about insuring for new developments; that the allowed rate of return on those developments must match the risks. So there is a degree of regulatory uncertainty as it applies to new pipeline developments. At the end of the day those developers have a choice - they either proceed or don't proceed. Equally important is the fact that those existing developers who have sunk their capital over the last 10 years in particular must be able to achieve a return on their investments.

On the pipeline approvals front, I think it's fair to say the approvals processes in some states are very cumbersome, slow and have very uncertain time-frames attached to them. Under normal circumstances this is an irritation for the industry, especially for major pipeline developments, but it is an irritation that has to date not stopped projects from going ahead. If you look at the next stage of pipeline development in this country, it will be a period of consolidation as markets grow and the industry looks towards much shorter lateral pipelines servicing the needs of mining and other major customers in regional Australia.

If those same principles are applied to those smaller pipelines, there will be real problems in terms of new pipeline development, so that is adding to the point that my colleague made. We really need a process that reduces the uncertainty attached to time lines for lateral pipeline development. We need certainty in terms of how jurisdictions approach the new pipeline development and we desperately need a one-stop shop across all jurisdictions, because this is mainly the state government level where there is an active process of facilitation as opposed to concurrent government approvals on an issue-by-issue basis. It's an issue of growing magnitude as the major pipelines are put in place and as the next stage that is lateral development is pursued more vigorously by the industry.

The next point I'd like to make is really the growing importance of research and development. Australia as a country is characterised by gas reserves are very remote from major markets and from most regional markets and we need to be world class in terms of those long, skinny pipelines that meet individual market needs such as mining. They have a relatively small load in terms of gas and they're often very long in terms of their distance, so an ongoing research and development effort is of critical importance to this industry and is something that is of major benefit to regional Australia. That is something that hasn't really been picked up to date, as I read it, in the Productivity Commission report.

Just to reinforce my final point, which is about a key missing element in Australia's gas market reform agenda, and that is upstream reform and greater

diversity and competition at the producer level. It is an issue that is reflected in the report and it is an issue that is very strongly supported by APIA. So with those comments I think we should just open the questions.

MR COSGROVE: Thank you. Could I ask you to give me a clearer understanding of what causes these delays in approvals, the regulatory problems that you have. I imagine environmental aspects are one part of the issue, but what else is involved?

DR BEASLEY: In most jurisdictions there are a series of steps one has to go through to get a pipeline licence. There are obviously now the access principles, the pricing of access to the pipeline, environmental approvals, cultural heritage approvals and then the technical approvals associated with the nature of the engineering. They are all equally important. Some states are much better than others in terms of coordinating that overall process. Some states take a parallel approach and look at all these issues at once and give a final pipeline licence within a very reasonable time-frame of around eight months. Other states - and I would note New South Wales as the particular case in question for recent developments - can take more than two years to approve relatively straightforward pipelines.

The example I would give - and it relates to regional development - is the interconnect project between Wagga and Albury which crossed 151 kilometres of agricultural land - that is, disturbed land - and yet took around 28 months to gain the necessary pipeline approvals for the project to go ahead. 151 kilometres is the sort of length one would expect to be applied for a whole series of lateral pipelines servicing mining and other discrete regional markets and, if those same delays were to be imposed on lateral developments, then it would be a very significant impediment in the overall process.

MR EVANS: Yes, if I can just reinforce that, quite often it has been the situation where approvals processes are taking longer than the actual construction period, so it's taking more time for state governments to do their paperwork than actually physically putting the pipe in the ground. This is a clear issue where there is an obvious regional benefit and regional spin-offs at a time when there's withdrawing infrastructure in many respects in regional Australia where we've been faced with unacceptable delays at the government level.

MR COSGROVE: That regional spin-off, Greg, I guess has been important especially for some of the larger users, including mines. Are there any ways in which what you might call smaller-sized gas consumers have gained from this process of extending the network?

MR EVANS: Yes. It has varied between markets. For example, in Western Australia gas infrastructure has been predicated on value adding mineral processing, etcetera, whereas I think probably now - and Allen might want to speak further to this with respect to regional New South Wales - there are benefits from these lateral spin-offs in terms of lighter industry. I think some of the examples may well be abattoirs, canneries, and light manufacturing in those regional areas which previously

have not had access to that energy source and now there is that potential. I don't know if there is any other further examples, Allen.

MR COSGROVE: Household consumers of gas in some rural towns. Would that have been of benefit at all?

DR BEASLEY: If I could just make that point, in terms of residential customers, a whole series of towns have been reticulated with natural gas over the last 10 years or so. To that extent, they gain an energy source that they haven't been able to use previously which is cost competitive relative to the other energy choices.

MR COSGROVE: Sounds as though that wasn't driven by NCP though, Allen, if you said a decade ago, it was just a decision by the pipeline companies to develop new markets.

DR BEASLEY: It's spread over that entire period and, you're correct, it can't be attributed entirely to the national competition policy reforms. But referring to the free and fair trade, that opportunity would not have been available had not the transmission pipeline been built in proximity to those markets in the first place. We certainly see plenty of opportunities for that to continue. For example, the eastern gas pipeline, which is due to commence construction in August this year by Duke Energy International, will provide that opportunity for a whole range of regional markets along the way, including Cooma-Bombala, if the cost is right. The ultimate determination is the delivered cost of gas, and that's why one has to look at the gas market reform, the production elements, the transmission elements, and indeed the distribution elements.

MR COSGROVE: If you come to the producer stage are there unnecessary impediments, would you say, to the development of greater competition at that stage of the process?

DR BEASLEY: In terms of producer competition it is an issue that is being addressed through the Council of Australia Governments. A report was sent to first ministers towards the end of last year, and it focused on the importance of openness and transparency in acreage release and management; in other words, getting new potential producers into the marketplace. It focused on issues in relation to joint versus separate marketing of gas where you have to weigh up the costs and benefits of the different approaches, and it also addressed the issue of access to certain upstream facilities where there may be economies of scale associated with providing a third party access to such facilities.

MR COSGROVE: So the pattern has been one, has it, in which I guess state governments have allocated production rights to a small - - -

DR BEASLEY: And in many cases - and to be fair it dates back perhaps 30 years - those production rights have been granted over very large areas of land for a very long period of time. Some of those arrangements are coming through for renewal

and

we're encouraged by the fact that states like South Australia and Queensland, in particular, are taking the approach of breaking up that acreage with a particular view to encourage greater producer competition. There is an additional element that can add to that and that is the prospects - the coal seam methane, particularly in Queensland and New South Wales, which is an emerging element of producer competition which we see as having great benefit in the medium to long term.

MR EVANS: Yes, just if I can add to that, if you look at the entire gas chain you are potentially seeing an uneven application of market reforms; that is, in transmission and distribution. In the middle of the chain you are seeing third party access guidelines taken up and utilised, however there are difficulties there. But with respect to upstream you're not necessarily seeing that level of reform, whereas if you go further right down the chain to the retail end there is now retail contestability which is coming into the marketplace across Australia. So you really have to look at reform across the whole chain to properly get the benefits of competition reform and at this stage it's the upstream sector which has been the difficult area.

MR COSGROVE: Would you say that that's meant to be picked up under NCP or is that a separate issue, the upstream competition part? The access code is the essence of the NCP angle, isn't it, together with structural reform of gas monopolies in certain states. I'm not sure about the - - -

MR EVANS: In terms of the exact definition and border areas, I'm not sure.

DR BEASLEY: The national competition reforms, particularly because they relate to the competition payments, were certainly associated with downstream reforms, the so-called natural monopolies, however it was predicated on the basis that that would act as a stimulate for greater competitive outcomes upstream as well.

MR COSGROVE: Yes, you mentioned also there was a need to improve the access regime. Could you tell us what you have in mind there? It might have been Greg who made that point.

MR EVANS: I think where it's at the moment, in terms of - those asset owners who have been using the code, etcetera, and need to put in access cases, have found that limited flexibility in the code and the amount of information that they need to supply to their relevant jurisdictions has been quite excessive and in fact they haven't been able to necessarily pass those costs on. So there have been significant compliance costs associated with providing that information which have been largely absorbed by the relevant utility, or whatever. So I think that has been a major issue which is probably mitigated against the earlier accessing or the early delivery of competition benefits in different markets, and I think it's reducing the amount of investment that otherwise might be attracted to a given market or reducing the amount of new pipelines, etcetera, that might be built due to the difficulties in understanding the regulatory environment.

DR BEASLEY: If I could perhaps just add to that point, a lot of the recent

development and those assets that were privatised in the early to mid-1990s were developed and privatised on the basis of a different model, and it was basically the negotiate-arbitrate model, and there wasn't the same degree of prescription in terms of the pricing principles and other arrangements that would apply. APIA is not saying that the system will not work, we are simply saying that the system as it relates to the national access code is yet to be tested on those particular assets, including recent developments and privatised assets, and it must work for them as well as for new pipeline developments if the industry is to have confidence in developing new infrastructure. So it's as yet an uncertain outcome.

The regulators, to their credit, have said that the recent cases which relate mainly to downstream network assets should not be seen as a precedent for future developments, but of course it's not until you see the outcomes and a range of outcomes delivered into the marketplace that the industry will have confidence in that particular process.

MR BRAITHWAITE: Some of these major mining ventures, would they seek access as a means of getting the gas, or are they prepared to be treated as a customer? For instance, you've got a big mining venture in Western Australia - are they on a contractual basis or would they for some reason seek access to the system and distribute not only to themselves but along the line?

DR BEASLEY: Yes, they have in fact a range of options. If there is already an existing pipeline they can certainly seek third party access and gain access in that way. If on the other hand - and it's the case that in many markets there is no pipeline, hence the point about laterals - they can actually go out to a competitive tender process to seek expressions of interest from a range of pipeline developers and get the best price that suits their access requirements. They then have to negotiate, however, a price with producers so that they see the ultimate bundle cost of ex-plant price, transmission, and that gives their final price into the market.

MR BRAITHWAITE: Yes, and what about at the beginning of the day, the royalty situation? Is that fair and equitable across Australia?

DR BEASLEY: Royalty issues are more a key issue for producers but our perspective is that anything that adds to the price of delivered gas can be an impediment to gas trade and development. So we certainly wouldn't exclude royalty regimes as a potential impediment. In Queensland they're in the process of reviewing their legislation right now and have foreshadowed the possibility of different royalty arrangements applying for certain new developments, such as coal seam methane, which require a different approach to gain some initial market share. But this is certainly not the forum where I think we would be making major points about royalties relating to the states.

MR BRAITHWAITE: No, I was just thinking in terms of states who are now looking at this cost recovery and valuation of royalties, as to whether they have seen any opportunities to significantly increase or review their royalty regimes.

DR BEASLEY: We would certainly hope, if they review their royalty regimes, that it would be in the opposite direction rather than seeking to attract any rents that might be in the system.

MR COSGROVE: I was interested, Allen, in the point you made about research and development. Is this an area where you perceive a degree of market failure? In other words, it's not in the commercial interests of the pipeline companies themselves to undertake that research.

DR BEASLEY: This is an issue we're pursuing within APIA as a matter of priority and we have in fact brought together a body of pipeline developers to cooperate at the precompetitive stage. So on issues such as improved welding techniques, improved and lighter weight steels for pipelines, we're getting a very high level of cooperation. I wouldn't characterise it as a market failure, it is more an issue of regulatory risk, because as we move along the path of viewing access arrangements put forward by developers certain customers who gain access to gas may well take the view, "We see research and development as an unnecessary add-on to the overall cost structure for pipeline access." I would be very concerned if that were to emerge as a situation.

There has to be a recognition, in Australia in particular, that research and development aimed at reducing pipeline construction costs brings more gas to markets; it grows the market load; and therefore everyone can benefit from lower gas transmission haulage rates.

MR COSGROVE: But that could be said, say, of some breakthrough, let's say in motor vehicle technology which likewise produced some significant flow-on benefits to other parts of the marketplace, yet that wouldn't seem to me to be a case warranting any public intervention. I'm not quite sure that's what you're suggesting though, but I'm struggling to understand. You mentioned regulatory risk. I couldn't quite see how you brought that in.

DR BEASLEY: Well, it can be regulatory risk. A regulator looking at the structure of a regulated natural monopoly may well view such research and development as an unnecessary add-on to the overall cost base. The point is, we see it as being very fundamental to the long-term development and growth of our industry, including in regional Australia, and that's why we raise it here.

MR COSGROVE: Would the regulator take a different view depending on who financed the research and development, ie, private versus public funding?

DR BEASLEY: We are talking about private funding, but at the end of the day a regulator may well take the view that to a degree that's being picked up by customers, in terms of the overall cost structure for the haulage tariff rates.

MR BRAITHWAITE: What is the actual history of why gas prices are being capped? You talk in terms of wanting more freedom on prices, suggesting there is a

type of cap there now. What's the history of capping?

DR BEASLEY: I think the reality is the capping has primarily been directed at capping the price for residential customers because it's a state political issue, and that over time has of course led to cross-subsidies.

MR COSGROVE: As we've seen in fact in electricity as well.

DR BEASLEY: As we've seen. We strongly endorse a path that unwinds those cross-subsidies over time, and that is certainly the path that is occurring in some states and I think the draft report itself referred to certain changes in residential gas price versus industrial. Certainly for regional Australia cost-reflective pricing is going to be very important if they are going to get relatively large quantities of natural gas at the lowest possible price. So we certainly don't want state governments in particular to squeeze overall returns, at the same time demanding that prices be capped for residential customers.

MR COSGROVE: Was that information in our draft report - some of which may well have been drawn from an earlier submission by the Gas Association, perhaps - reasonably accurate, would you say? I don't know whether you have it in front of you but we have for various periods real price declines, mainly in WA and Victoria, of between 7 and 11 per cent. There's a very large drop. This is a period essentially of about five years, from the early nineties to the mid-nineties. It's on page 247 if you happen to have the document with you. For the six major distributors, real controllable costs, and an indicated 22 per cent decrease in gas prices for industrial and residential users, it would seem, calculated on some nationwide basis. It may not be the sort of thing you can address right now but should you have any capacity to tell us whether we're right or wrong on those we would be grateful for a check.

MR EVANS: Yes, I don't think we specifically referred in our submission to particular price reductions, however it may well have been based on some of our industry's statistics that are available publicly.

MR COSGROVE: It's probably come from some work which we do with the state governments, as I see now, the source of that table.

DR BEASLEY: As I recall one of those was a survey that was carried out with NUS. There was a survey. In the other cases, in the interests of accuracy, it might be prudent to look at whether we're talking about actual end customer price or the haulage tariffs. That would be my comment.

MR EVANS: We did make the point in our submission that since 1973 the average residential price of natural gas has fallen by around one-third in real terms.

DR BEASLEY: The point is, in terms of haulage tariffs for those arrangements that have been through the national access code processes, there has certainly been a reduction in tariffs, but I can't comment on end customer price.

MR COSGROVE: Greg, there was a point in the Gas Association's original submission to us about competitive neutrality as between gas and electricity. It's on the last page of your submission. You expressed concern that:

The effect of artificially low electricity prices derived from a lack of a requirement to achieve a commercial rate of return on assets will be to undermine future pipeline infrastructure development.

That was a submission which we received in early November. Some time has passed since then. I was wondering whether the situation has shifted at all in that particular respect.

MR EVANS: I can't comment on the movement since that time.

DR BEASLEY: I recall a report about two weeks ago reviewing electricity prices over the last 12 months, and I think that was NUS as well, which indicated that in fact prices had recovered somewhat. I don't recall the exact magnitude, but that would be readily available, so there has been some recovery since that time.

MR COSGROVE: But could either of you tell us whether there has been any significant effect in terms of undermining future pipeline development or is it more a prospective concern? My general impression, admittedly that of a layman, is that the process of pipeline development seems to be proceeding reasonably along the lines intended, but this reference in the earlier submission made me wonder whether there was a serious problem here or not.

DR BEASLEY: Well, no, I'm not going to accept that. But I think the point I'd make is natural gas is a discretionary fuel in most markets, especially in a country like Australia, where we have abundant low-cost coal reserves. The tendency in an electricity market to be driven by the lowest-cost producer certainly has driven the national electricity market to coal at the expense of gas over the last three years in particular and there has certainly been an increase in brown coal use and basically a corresponding decrease in natural gas use. Whether that's a long-term trend, of course, depends on the future nature of the electricity market and supply and demand.

We would be concerned if governments take an approach based on underbidding into the national electricity market simply to secure market share at the expense of new prospective developments. The ABARE forecasts indicate very strong growth potential for natural gas into power generation. It also achieves environmental benefits, particularly greenhouse, and it's an area - whole of government, state and federal - that warrants continuing examination.

MR COSGROVE: I think we had in our draft report a table - page 127 - showing the trend in employment among the six major distributors of gas over a five-year period. We ventured the view that that decline might have been offset in several ways. It's actually spelt out on the preceding page:

Increased employment in firms providing services to gas suppliers as a result of greater contracting out by them; employment gains resulting from the expansion of the gas network into rural and regional Australia; and higher employment in user industries which have become more competitive as gas prices have benefited and -

are you able to tell us whether that assessment is likely to stand up in your experience in the industry.

MR EVANS: I think that that's a reasonable view and I think there are second-round impacts of reforms flowing from the gas industry and having access to gas and more competitively priced energy.

MR COSGROVE: Mineral processing seems an obvious example.

MR EVANS: Yes. There are these substantial second-round benefits and it's the whole premise on which gas infrastructure investment is taking place at the moment. There will be large second-round impacts and I think those employment observations you made there are quite accurate, yes.

MR COSGROVE: I don't think I have any further questions. Ray, do you?

MR BRAITHWAITE: The competitiveness of electricity against gas - as I understand it, the pipeline from New Guinea is going to feed substantially into the Gladstone market. Will you be competing very actively against electricity there to get that contract?

DR BEASLEY: The major markets, in fact, for that natural gas is for power generation, so it is more an issue of inter-fuel competition, gas on coal, that is the issue relating to the PNG pipeline. As things stand, there's certainly a growing wedge of disparity between supply and demand for electricity in Queensland and the PNG project is a very critical element to the pipeline industry in meeting that particular gap.

MR BRAITHWAITE: It was probably in generation I was thinking about. But you would be competing with a major powerhouse very close to Gladstone, wouldn't you? It's the shortage of electricity in Queensland that makes it probably more acceptable.

DR BEASLEY: It is certainly one of the factors that can attract foundation customers for the PNG project, as are, of course, major industrial customers, such as the Comalco alumina plant, where natural gas would be seen under most circumstances as the preferred fuel.

MR COSGROVE: That's at Bell Bay, isn't it?

DR BEASLEY: No, that's at Gladstone.

MR BRAITHWAITE: So in actual fact, any power generation from gas is filling a need as far as production in Queensland is concerned, generation production.

DR BEASLEY: That is correct.

MR BRAITHWAITE: A shortage at the moment.

DR BEASLEY: That is correct.

MR BRAITHWAITE: The approvals system worries me. I think you broke them down into the environmental, the pricing access, cultural heritage and technical approval. Now, did I understand you to say that in Queensland it can take you seven months, whereas in New South Wales it could take two years?

DR BEASLEY: That is correct. There is an amazing disparity between the states in terms of the time it takes to gain these state-based approvals.

MR BRAITHWAITE: Can you pinpoint it to any particular department? Is the difference in the environmental approach in Queensland and New South Wales different, or the cultural heritage?

DR BEASLEY: I think the problem is that in New South Wales, you can't pin it down to a department, because there are around five approval departments involved. They all approach their task almost in sequence and that adds a lot to the uncertainty and delay. The figure I would mention for comparison is the Carpentaria pipeline from Wallumbilla to Mount Isa. I think it took eight months to gain necessary approvals and, as you know, 28 months for the - and that was an 800-kilometre pipeline, as opposed to over two years for a 151-kilometre pipeline to serve agricultural land. So we do have really issues in New South Wales. We are seeking to address those jointly as associations, but it is nevertheless an issue that is relevant to this report, in that it relates to environmental and other approvals for lateral pipelines into regional Australia.

MR BRAITHWAITE: Has Queensland got a one-stop shop approach more than New South Wales?

DR BEASLEY: Most definitely, and in Queensland, notwithstanding the fact there are going to be some changes in that environmental approvals will be moving across from the Department of Mines and Energy to the newly-established Environmental Protection Agency. They are taking a very proactive approach with the pipeline industry in discussing with us our needs in maintaining that one-stop shop facility, and that's certainly part of the whole of Queensland government philosophy in relation to new pipeline developments.

MR BRAITHWAITE: Thank you.

MR COSGROVE: Anything else you wanted to mention to us?

DR BEASLEY: No. Thank you for the opportunity.

MR COSGROVE: Thanks very much for coming along. I'm not sure our next participant is here. We might just take a short adjournment.

MR COSGROVE: Our next participant is the Council of Small Business Organisations of Australia. If you wouldn't mind, please, for the purpose of our inquiry, identifying yourselves and the capacity in which you are with us today.

MR BASTIAN: My name is Robert Bastian and I am the chief executive of the Council of Small Business Organisations of Australia and that may condensed sometimes to the Council of Small Business or COSBOA.

MR HOUGHTON: My name is Kim Houghton and I am the projects manager with COSBOA.

MR BASTIAN: Is it traditional that you make an opening comment and then dive it?

MR COSGROVE: That would be fine.

MR BASTIAN: We have obviously read the report and the area of endeavour is extremely important. You will noticed that there are a heck of a lot of small businesses out in regional Australia and therefore, I guess, we have a particular interest in this inquiry. We have a document which I regret not having got to you before we arrived but it is hot off the press this afternoon and we will be speaking across that and leaving that as part of the record. The document is COSBOA's letter dated 20 July 1999 addressed to Commissioner Plunkett.

MR COSGROVE: We should take that as a submission at this stage?

MR BASTIAN: Yes, if you would, I would actually like it recorded as a sub, if that is possible.

MR COSGROVE: Yes. Thank you.

MR BASTIAN: I will in fact pass two copies across to the commissioner now. Without making a long speech on opening, I intend to follow pretty much the line of this quite short submission. In essence, we do have a concern with the recurring theme within the report - and, I guess, throughout the competition policy debate - about the basic assumption that wealth, once created, trickles down. The evidence that we have tried to present here to this inquiry, and others - quite recently we have had the retail inquiry - is that there is an increasing amount of quite solid evidence to the contrary to show that within the business community wealth or commercial wealth - certainly revenue - is polarising or concentrating up.

One of our fundamental positions is that we all know that very small firms are providing much of the employment in the nation and that is no secret, but if wealth is concentrating up and jobs are coming from down, then there is a fundamental issue. We don't therefore feel that many of the claims within the draft report implying that

ultimately wealth created will trickle down satisfy us. We have attached some quite reasonable evidence prepared by IBS for BRW showing this phenomenon, particularly in firms employing over 1000 - sorry, the top 1000 firms, and whilst we recognise that that is only one data set, it does show the point we're making, I think fairly graphically. So we come back to that issue several times.

We also attach to our letter two cuts through the IBS material. The purpose of putting two cuts, one from 1993 to 98 and the second from 1997 to 98, is to try to demonstrate that this phenomenon which concerns us deeply is in fact intensifying, and we can talk to that. Beyond that, I guess we make the point that in talking about competition and trying to establish within the Australian community confidence that the national competition policy is actually working for them - and there is a lot of evidence at the start of the report to show that people in the bush don't think that it is. We would urge that the final report place particular emphasis on defending its projections in a language which is understandable by its recipients. It is incredibly important that Australia has confidence in this process and I would have to say that certainly at the smaller end of town there is not a lot of confidence at the moment, so the objective of actually selling the projections is, for us, extremely important.

We have got a little bit of evidence here which we will go through with you blow by blow, but just to round off my opening remarks the final issue is that in work that we have previously done which led to the production of a report called Jobs In Our Region, which is most certainly held by the commission, we came to the point where the decision-makers in Australia have a particular information flow problem. They really do not have much in the way of usable, timely, appropriate information on which to make their judgments, and I think that this report could do a lot to accent.

Decisions are being made day in, day out in regional Australia and in the bush and certainly in metropolitan areas and, quite frankly, right across the nation and they are made on the basis, we would suggest, of not malice but poor data, and small business as a concept is not well understood by a lot of people. They sort of visualise little Aussie battlers on corner shops when they really do need far, far more sensitive size-dimensional information on which to judge the impact of their decisions - not only judge them statically at that time but also project them forward better. I think that was the premise on which we did that work and, quite frankly, there is nothing that I have seen since or in this report to shake that.

So we have actually come down to clean reports at the end of our fairly short submission: one, that the final report should better support its projections in language understandable by its recipients. We do have some trouble with the assumptions in the report and I will go over that but, trying to put a positive kink to it, is incredibly important that people understand what is being said in your end document and can understand that it is not just part of the flat earth, rationalist, economic "She'll be right in the end if we just let competition sort it all out" line.

The second recommendation is that the issue of providing usable data, particularly in relation to small business interests, to regional decision-makers - and

there are many of them - as identified, and jobs in our regions be addressed.
Recommendation 2, I guess, would go a long way to supporting recommendation 1.

MR COSGROVE: Thank you.

MR BASTIAN: Those are fairly lengthy opening comments - I am sorry about that.

MR COSGROVE: That's okay. On that second one, Rob, could you give us some indication as to what you would think of as "usable data"? What sorts of things?

MR BASTIAN: The needs, I guess, are located in an area which concerns us. We have made no bones about our concern about concentrating capital and the fact that Woollies isn't essentially a capital-intensive organisation and that to the extent that we trend towards capital-intensity, the only answer is that we are losing jobs - hang on, I will put that a different way. We are trying to argue that the labour-intensive end of our economy has a social merit which, if you want to, you can argue economically to say that by allowing a little bit of support for labour-intensive firms, not assuming that bigger is necessarily better - there are social issues involved, employment being the major one, and that if you look harder at those social issues you can actually quantify them and find economic consequences of dislocation - despair, drugs, crime, all that sort of stuff - and those are quite quantifiable; they are not just wishful thinking.

In order to equip a local decision-maker to properly determine whether or not it is desirable, for example, to extend or not to extend shopping hours or to allow a shopping centre to be developed or not developed - in the face of incredible pressure by large retailers particularly, or large developers, to develop those things - the decision-maker needs to have information so that they can properly judge the merit of that development. Let me give you a classic example. Two years ago, less even, in this town, in Manuka, there was a bit of a kerfuffle about whether or not to extend Manuka. The extension is taking place as we speak. Particularly Woollies were speaking in favour of it. Now, in a shrinking economy with in fact a shrinking demand for loaves of bread and bottles of milk, a larger part - - -

MR COSGROVE: A shrinking population, I think, at that stage, and maybe a shrinking demand for loaves of bread and bottles of milk but, I think, a growing demand for just about everything else, including real estate..

MR BASTIAN: Let me run my argument. My argument was that there was a basic movement of people out of Canberra at that time - - -

MR COSGROVE: Yes, but still higher total incomes.

MR BASTIAN: But they don't eat more.

MR COSGROVE: No, but they spend their money in various ways.

MR BASTIAN: Okay. Let's stick with Woollies here, let me just finish the point

that I am trying to make, that in a shrinking economy - as Canberra was at that time and possibly still is - the argument was being put that to concentrate retail dispersal through a larger Woolworths store at that point, or a larger retail store at that point, that this would create jobs. Nobody really believed that but that was the public debate - being pressed by a large and powerful organisation, and we were only arguing that, to judge that decision, the people in Canberra at this time - using this example - might have been better served with, I guess, a capacity to analyse the real employment impact of that decision, post the construction phase.

Whether or not you actually take that logic or whether I can defend it might point the thing - it should be either a yes or a no, it shouldn't be a maybe, and really it comes down to who shouts the loudest in these questions, and that is happening right across the nation. We have on occasion won that debate publicly; on other occasions we have not. Since we are up and talking on this subject, one of the core findings of this document, Jobs In Our Regions, was that if you have an expanding economy certain infrastructure decisions are sensible; if you have a static economy certain infrastructure decisions are very questionable; if you have a shrinking economy they are very difficult to defend, particularly when you move the epicentre of shopping away from the main street, unconsciously move it away, as has occurred in several places in the Hunter. You asked the question, what do we mean by - - -

MR COSGROVE: Yes.

MR BASTIAN: The issue is that we go out there and we find that the people making these decisions do not have at their fingertips usable data which actually shows them what the small business impact is and, of course, there is an assumption here that small business does create jobs and is valuable for that purpose.

MR COSGROVE: Yes, okay. You mentioned early on, Rob, that there was solid evidence against the point that, as you put it, wealth trickles down - - -

MR BASTIAN: Yes.

MR COSGROVE: Is this IBS BRW material attached what you have in mind?

MR BASTIAN: Yes.

MR COSGROVE: What is it based on? Do you know? Is it a survey or - - -

MR BASTIAN: Yes, IBS presents to BRW each year, about October-November, the employment and revenue shifts for the top 1000 companies. This is no more than a replication of that work.

MR COSGROVE: I see.

MR BASTIAN: If I could just draw your attention to the bottom figure on attachment 1, it shows - and I think it is reasonably straightforward - that with

revenue growth nationally at 5.3 per cent and employment growth nationally at 2.1 per cent for the top 1000 firms - and I understand that this is not a full sweep right across the business spectrum - revenue has grown for the top 1000 firms at a shade under 8 per cent and they have shed 1.4 per cent of their workforce. The rest - the non-top 1000 - have grown by a shade under 2 per cent and doubled the national average for job growth. That is quite consistent with Access Economic's analysis of the Office of Small Business slant, ADS small business trended data. I don't think there is a huge argument against the fact that many jobs come from small firms. We're not making a moral judgment about that either, incidentally.

MR COSGROVE: Yes.

MR BASTIAN: Our concern is that there is some evidence that the mere creation of wealth doesn't necessarily distribute it.

MR COSGROVE: No, that's correct, but nor does the creation of employment necessarily distribute it. You can have a concentration of employment growth, just as you can have an concentration of wealth growth.

MR BASTIAN: Yes, right. We have a concentration of wealth at the top end at the moment and that in itself is not such a drama, except for the fact that they are shedding labour and, yes, we do have a concentration of job growth but it's at the small end where the wealth isn't landing. That is the point of these figures. So what we're saying is that the outsourcing argument or the passing of jobs from large firms down to contracted small firms is okay if revenue is going with it. We're merely pointing out other people's data that suggests it's not.

The reason for putting those two graphs in there was to make the point, I guess, that over the period 93 to 98 the same figures presented the same picture but the bottom picture shows that it's intensifying a little bit; in fact, quite substantially. Over the five years in the top graph the average labour figure for the big end of town is 0.6 per cent, whereas for the 97-98 year it's minus 1.4 per cent. We haven't brought the whole of the IBS figures but that would tend to suggest that it's intensifying, which would be commonsense given the number of mergers going on around the place.

MR COSGROVE: As you say, smaller businesses often are involved in more labour-intensive activities than large businesses - not always but it's often the case.- but whether employment should be regarded as the principal objective of government policy I think is another question.

MR BASTIAN: Could I ask whether it is? I think it's certainly a very publicly stated government objective and certainly if one was to run through the electorate - and let's assume for one fleeting moment that the government is actually working for the electorate - then I think most people in this country and indeed this globe are very concerned about employment. So I do believe that if we are looking for a public benefit argument, to suggest that pure competition should be in some way stayed or

balanced, then if any public benefit could be put forward it would have to be employment. Actually, that's the reason we have always laboured this employment thing. It's not that we are arguing that small firms are in some way more noble than big firms, it's just that they happen to have this labour-intensive component and a traditional rationalist will always argue, time and time again, that efficiency relates to the use of capital, not the use of people.

MR COSGROVE: It relates to both. It relates to the efficiency with which you use all of your available factors of production, including land and capital and labour, but I'm sure if you were pursuing solely the objective of increased employment, you could come up with some pretty silly results in terms of the income levels of the community, which I think - if you use the phrase "standard of living", I suppose, more particularly - tend to be seen by governments as their principal objective. Anyway, that's part of a larger debate.

MR BASTIAN: It is actually but this is a very large debate. I mean, this is not something that is easy, there's no suggestion that there is a silver bullet to this thing. But nevertheless I come back to our main issue: right through the report it repeats over and over again that if we create wealth it will trickle down. That has been a central theme for - - -

MR COSGROVE: I'm not sure that that's an accurate interpretation actually. In assessing the effects to date of competition policy reforms we have tried to look at changes in costs and prices, in the quality of service and in employment, in particular. We have looked at some other things as well but they're the main things we have looked at. Then we have made use of some longer-run modelling estimates to get a feel for what might eventually come from the fuller implementation of these reforms, and there too the indicators we have looked at are output and employment and combining those two measures of output per person employed.

Whether you look at the effects to date or the longer term illustrative indications of what might happen, we have found that there is a mixed set of effects that additional competition, while in the long run we think is likely to result in increased output, is unlikely in all regions to result in increased employment. In fact, in some it will result in decreased employment. So, yes, you're right in the sense that we have come to a view that in the longer run increased competition is likely to increase national output and national welfare in terms of consumption, but it's not a universal pattern, if you like.

I think our overview makes the point that when you're looking at regional areas, in particular, there is in fact a wider dispersion of both gains and costs as compared with the metropolitan areas. So it's a little bit of a patchwork quilt but I think generally we see output gains but not always showing up in terms of your preferred indicator of employment.

MR BASTIAN: Actually, could I come back on that because it is an issue that we have been grappling with. Oddly enough, COSBOA's natural instinct is a shade right

of Attila the Hun. We don't seem to be able to resolve this unemployment issue and it has stuck at about 7 per cent, and it's really wavering around there. It might go up; it might go down - - -

MR COSGROVE: It may be stuck but it has been coming down significantly over the last 12 months.

MR BASTIAN: There have been some fairly respectable people saying that that might not be sustained.

MR COSGROVE: Others perhaps indicating that it might - but, anyway, go on.

MR BASTIAN: We're not saying for one second that efficiency is not to be pursued. We're not saying that increased productivity is not a wonderful thing. We're not even actually saying that competition itself is not a very, very good thing - contained. What we are saying, I guess - the let-out that no economist would deny - is that competition isn't all there is. There is a public benefit concern. It's just that the definition of public benefit is not something which we seem to be able to manage to work into our economic debate because it's such a slippery term. In my heart I believe that the public benefit that most people assume is employment.

Somehow, I guess we're trying to factor that in as hard as we can, not because we're noble but because I'm a small business advocate and the characteristic of small business that this society wants has bugged all to do with its size; it's to do with its labour-intensity. No-one cares, essentially, about the noble struggle of the little corner shop. It's just that the nation has some instinct that they do provide a fairly large slice of our employment and our jobs. The jobs don't come from the size of the firm; they come from its labour-intensive character. So to some extent the debate - and I think that you people are more capable of doing it than I am - is a balance between the perceived efficiency of capital, the use of capital, and the reality that people want a bit of labour-intensity there somehow.

It's not an easy argument to run but it has to come in somehow. Can I say, it's not off the wall. I have just come back from giving a pitch in Dresden in Germany, and in England they have stepped tax rates specifically for small business - I think 30 per cent and 20 per cent - and they are implementing a 10 per cent tax rate.

MR COSGROVE: We used to have that too, I think.

MR BASTIAN: But they have shot for the wrong solution there. They have shot for the size of the company when, in point of fact, the European Union is looking at splitting the VAT to encourage labour-intensive firms. I'm not suggesting that that will get up but at least the debate is being run.

MR COSGROVE: As I said, you can do all sorts of things if you want to increase the number of people employed but often they have perverse effects and that's why people, on second thought or third thought, tend to not implement them.

MR BRAITHWAITE: You would think it would be a pretty safe bet to say if we took off payroll tax there might be some encouragement for people to employ.

MR BASTIAN: Oddly enough, we do support that as a principle, however - and this is slightly straying from, I guess, purely regional matters but in economic terms I think that we can sustain an argument along the following lines - and it comes more to the tax debate as distinct from regional development. It comes into competition policy, as everything does. We do agree that payroll tax is an anti-employment tax but, by chance, the very small people who are providing our jobs by and large don't pay it. So it falls into the weighting between the advantages of capital versus the advantages of labour, which we have just been discussing. To remove payroll tax would probably, on balance, advantage the capital holdings of firms which already have a capital advantage.

So whilst on principle we agree with it as an anti-employment thing, we really would rather that the tax-induced costs in the current system that relate to labour, which aren't on Mr Rolf's agenda, receive a far greater focus than the removal of payroll tax. Let me explain that. Basically, the Rolf report will almost certainly look at improving the efficiency of taxing capital. He has stated that publicly as being one of its central objectives. Paradoxically, small firms are struggling with the labour-induced processes of the tax system; that is the collecting of PAYE tax, the handling of superannuation and the collecting of it, the handling of HECS and child support and other labour-intensive things which are in the tax system which, being perverse, are not taxes so they're not actually there.

Those are the areas where small business could I think legitimately be given a hand without, in my view, shall we say, offending our rationalist economists, because they are a burden which the sector has identified as bearing a greater weight by this very organisation when it was called the Industry Commission.

MR COSGROVE: Rob, certainly - as Ray and our other colleague, Judith Sloan, who is not with us today, will do - I will look at the material you have given to us after we have finished here today. I did notice one point - it's on the second page - claiming that we have asserted, without evidence, that more liberal trading hours have been of benefit to consumers and appear to have increased employment opportunities, including in country Australia. I think it's a little unfair to say that we have come to that view without any evidence. In fact, I would have thought the preceding several pages leading up to that finding contained some real evidence. It was reinforced by a hearing which we held in Bendigo, a week or so ago.

We had been aware, of course, and I think we cited somewhere - I can't find it now - in this section the outcome of the referendum held when certain groups in the community requested a referendum to test whether the community did want Sunday trading, in particular, or not. People there were telling us that not only did this suit the citizens, because they voted in big numbers for Sunday trading, but it also was proving to be a source of additional small business activity, not necessarily in the

independent supermarket area but in other forms of small business such as - furniture was mentioned, in particular - but also it was resulting in increased employment.

Unless one takes the view that there is something special about Bendigo which doesn't have applicability in other parts of the country, I think there is evidence that the liberalisation of trading hours does have those effects, if only because it increases the size of that market. There may be some redistribution of spending power away from other areas of economic activity but we have drawn on some information about growth in employment as a result of this change which looked pretty compelling in the state of Victoria, in particular.

DR HOUGHTON: It's very hard, commissioner, to draw a link between the changes in trading hours, as you would know, and the levels of employment in the retail sector. The sector is very diverse and we didn't really see a sound case here that there was a link between the deregulation of trading hours in Victoria and the employment patterns in the state.

MR COSGROVE: Bear in mind this is not some thinking that we have come up with of our own, we're reporting what people are telling us is the effect of this.

DR HOUGHTON: Yes. We're simply saying that the conclusion the commission drew, which was that these changes have led to increases in employment, were not substantially backed up by the evidence that was presented in the report.

MR COSGROVE: You're right in the sense that employment is the outcome of a number of influences but I think it would be difficult to say that, given what is happening in terms of the way people use their time in modern communities, a restriction on their capacity to undertake certain types of expenditure is likely to help employment. It may, but I find it hard to imagine.

DR HOUGHTON: The arguments have been run before and I don't really want to sort of repeat them here. The state government in Queensland last year looked at it in some detail when it was deciding whether or not to extend trading hours in the south-eastern region of that state and they decided not to. The Industrial Relations Commission decided not to, for its reasons. There are more brains at work on this than are in this room so I don't really want to, you know, think about all the links in the chains in that argument. We were simply trying to report that in our view that is the contentious area.

It's one in which small business has had its hand on its heart for a long time and it has been watching and wondering in a hundred different parts of the country, and we simply felt that the conclusion the commission drew, which is "On this evidence it's clear that these employment effects are positive" was not really based on the evidence that's presented. If there's more evidence behind this, then I think that should be included, because it is a contentious area and one which will be looked at very closely by the audience for this report.

MR BRAITHWAITE: In defence of the commission, Victoria would probably have the most deregulated trading hours of any state.

DR HOUGHTON: Yes, it does.

MR BRAITHWAITE: And it so happened that Bendigo was a case in point where they demonstrated to us, both in the first instance and more recently in the hearings, that small business has benefited, and that tenancies had grown in the city heart. Normally the inference is pushing people out of the city heart, but tenancies had improved in the city centre and they still fulfil the tenancies elsewhere, and the people who gave the evidence were small business people, which gave the impression to us that trading on Sunday - and that was the issue - had brought a tremendous amount of benefits to Bendigo. Whether that's a one-off operation or not - I do know that you can go to other places in Victoria and find a lot of businesses that have collapsed because of trading hours.

MR BASTIAN: Could I be really clear: our position is not that trading hours is some sort of sacred cow that can't be addressed. Our position is, and always has been, that it has to be to some extent locally examined. Our concern is that very often the people examining it are struggling for decent information. Part of our concern with the national competition policy is this sort of overriding presumption that competition is always and inevitably the best way to go and I'm simply saying that to provide them with some better data to try to make those judgments would not be in any way a negative thing, surely. I mean, crikey, there have been big fights about trading hours since in fact COSBOA came into being about 20 years ago to start that process.

Can I just draw you to one strand of information which I'm not competent to lay out but I do know that when Mr Kennett extended trading hours pretty arbitrarily right across the state about 12 months later the insolvencies in Victoria were something like 30 per cent above the national average. It was a specific jump in Victoria which, in my view, followed very, very clearly the decision to arbitrarily extend trading hours right across the state without really doing it sensitively. You have greater competence than me to draw that link but there's been no doubt that 12 months down the track or 18 months down the track the insolvencies in Victoria were very, very high and it was an aberration for that state. So I don't think that you can necessarily draw from the Bendigo conclusion anything which could be run nationally.

The other thing that I would really like to lay on the table, and we've put this forward several times, is that we don't believe small business deserves any support at all other than as an investment in the community, some sort of economic investment. We believe that the case can be sustained if you argue it, and we've always tried to maintain the argument that consumer opinion is not the same as economic analysis. Very often we tend to feed into the economic debate consumer opinion, and the funny thing about consumers is they go home and become taxpayers and complain about transfer payments. So whilst they might like a big shopping centre at the end

of the

street they are equally concerned about the incredible amount of money that's going to the community as payments through the welfare process, and of course the two are linked but it's not for a consumer - - -

MR COSGROVE: Sorry, how are they linked?

MR BASTIAN: Let me put it another way: if you take COSBOA's position that maybe 2 cents off the price of carrots at Woollies may attract praise from a consumer, the same consumer walks home, becomes a taxpayer and looks at two people unemployed in the family home, or an increasing number of people on the dole and says, "That shouldn't be a good thing." We're suggesting the people are taken off the dole by labour-intensive firms and if labour-intensive firms cannot compete with Woollies, particularly when Coke supplies its product at about 20 or 30 per cent down for the same product - we could go on with this argument forever. It's not a simple argument and I'm not suggesting that it is, but a consumer opinion is not an economic analysis. That's all I'm saying. And we all too often collect - - -

MR COSGROVE: Nor, I would say, is a producer opinion.

MR BASTIAN: No, I'm not suggesting it is. I'm simply saying that collections of consumer opinion do not constitute hard economic facts. We all know that small business wants every Woollies in the street shut but a consumer wants the most convenient stuff at the cheapest price. Anyway, I think I've made my point.

MR BRAITHWAITE: Could I just ask the question, has COSBOA noted a trend of change in the small business you represent? Has there been a change from the corner store butcher to another retailer who is in the business, probably in the high tech business that you're talking about?

MR BASTIAN: You actually raise a very interesting point. I'm probably one of the longest-standing industry reps in the country. I've been there for nearly 14 years and I've watched quite a lot of change and I think the best way I can answer your question is when COSBOA was established it was almost entirely made up of industry-specific groups - butchers, bakers and candlestick makers. As a result of perhaps the period under Labor when many of the public sector demands were non-industry specific - that is to say superannuation, workers compensation, industrial relations issues, and a whole pile of issues which were not industry-specific - there was a gravitation of concern in the sector across to size-dimensional information rather than industry-specific. For example, a training guarantee scheme landed heavily on small firms, so we got a \$200,000 threshold in there. Provisional tax is a size-dimensional concern, so we focused in on that.

So you ask me the question, has our membership moved? Yes, our membership has moved from a group of industry-specific organisations trying to find some common ground for small firms to an increasing array of size-dimensional organisations, small business, combined associations, small business people, small business this, small business that. So the small business thing has become far more

real. A lot of public policy can be better divided on its impact in a size dimension than it can be in its industry dimension, paperwork, compliance costs - those sorts of things - and yet, coming back to our call for information, which is our second recommendation, very little data is actually cut so that you can draw a continuum, from small through to large, of the impact of that policy, no more so than in regional Australia, and that's where we were coming from.

The reason we wrote that book is we sent quite a detailed questionnaire to a thousand decision-makers in regional Australia - mayors, politicians of various layers, media people, business people, etcetera - and it came back with stunning clarity that they really do not have (a) any concept of size in their policy thinking and (b) if they are actually sort of getting across their thinking, they don't have the data. I've just said to you size-dimensional information is last year's argument. We're looking for labour intensity now. We want to grapple with that difficult thing that an economist is really balancing with capital intensive versus labour intensive. So it's not a simple argument. I'm not suggesting it is. There are no simple answers to these short questions, are there?

MR COSGROVE: No, not in this inquiry. Any further questions, Ray?

MR BRAITHWAITE: Yes. I'm still grappling with the useable data in the example you gave, but what you're trying to do there is sift from the information that's available to the BRW or whoever sources it, information that's more benefit to the small business person.

MR BASTIAN: No, to the debate. I will win my argument with the small businesses if you can give me the information. Let me run a couple of examples to you. Basically after sabre-rattling from COSBOA the previous government said it would tilt the procurement dollar to help the small business person, and I think the offer was 10 per cent. I then spent three years trying to convince procurement agencies to actually ask the size of the supplier. Until you ask the size of the provider of the information you have absolutely no idea what size firm is providing the service. So at the very fundamental level you don't even know. Right now, half the procurement agents in the country really have no idea how much of their purchasing comes from small business because they don't ask the size of the supplier. That is actually changing. I think we're getting a little bit better.

We make some weight in here about the procurement of energy, the supply of energy. We have been concerned for some time that by coming from the top down, as so many of the post-Hilmer reforms have done - energy being one but outsourcing from government activity is another - by coming from the top down you are in fact going the worst way about it because we all know who is providing it, in employment terms, of course, but you are squeezing the jobs out of the public sector without first addressing the competitive neutralities issues between local contractors, child support organisations, busing and train companies, and all these little ones down at the coalface.

By simply squeezing from the top instead of getting down and addressing the competitive neutrality issues first so that the local bus company and the local train company, or the two child support agencies - one is private; one is public - or the engineering works in the local government competing with the local contractors - if we would address those things first to protect the jobs and then gone back and squeeze the broader public sector to get the jobs out - or to become more efficient, which is the same thing - then we might have had less negative reaction to the Hilmer principle.

Taking energy - and we've tried to explain it here - by coming from the top down and offering, what, 30, 40, 50 per cent discounts to firms which are already blessed with huge capital, and even now not getting down to my end of town where the jobs are coming from - we are promised, if we sign our name on now, an energy advantage of 4 or 5 per cent six years down the track, maybe, whereas right now the big end of town, with all the capital advantages they have, are getting 30 and 40 per cent discounts. We raised this with the national competition policy people and I got a letter back from Ed basically saying it was all necessary to protect - I can't find it.

MR COSGROVE: "Need for time to allow the removal of existing cross-subsidies" - is that it?

MR BASTIAN: That's right.

MR COSGROVE: "And facilitate - - -"

MR BASTIAN: Yes, in other words because they're getting such a good deal we need to slow it down so that they don't find reality a bit too tough. This is merely an example, I guess. If you're going to bring in this sort of change we would have argued that the wiser way to do it would be to look to where jobs are going to be lost and protect them first and then pursue effectively capital efficiencies as a second order issue. That's our persuasion.

MR BRAITHWAITE: But you see no problem with dismantling the overstaffing of some of the major infrastructure utilities as existed before, do you?

MR BASTIAN: The overstaffing - yes, you mean with Telecom and things? Our plea has not been to oppose efficiency, it's just been to be a bit less doctrinaire, I guess, in the pursuit of competition policy and to look at some of the unintended consequences that we feel bear pretty heavily on us. This is only a defensible position if the population is screaming out for jobs and we're providing them. It's pretty straightforward, to me, and I think I've really probably laboured that point.

If I can just come back again - we're not suggesting for one second that competition is a bad thing, not at any point. We are grappling with trying to balance the efficiency that we need from a competitive nature against the downside of the social dislocation that comes from not having the jobs that everyone wants, and there

is a balance. I mean people are chasing for this third way, whatever that means. Capitalism hasn't quite delivered; socialism breaks the bank; there has got to be something in the middle. I guess to some extent we are suggesting that that third way could be achieved by a little bit more honouring of labour intensity, not because it's noble, but because of the jobs it provides, and it's not something that's easy to argue.

MR COSGROVE: No. I understand it's your position, Rob, but this is a very old debate. It goes back pretty much a century.

MR BASTIAN: Oh, you're not going to call me a Luddite! The Treasury used that line.

MR COSGROVE: No. There can be a Luddite element to it but I don't think I regard you as a Luddite.

MR BASTIAN: We are actually proposing new solutions.

MR COSGROVE: A Luddite is usually someone who is opposed to the introduction of new technology. But, no, it's really what has been called the labour-embodied theory of value, and I have to say that I think most people who have studied these matters will say that it's thoroughly discredited as a means of increasing employment and wealth. But, as I say, that's a big debate - or was a big debate. Ray?

MR BRAITHWAITE: Just on the public interest test that you were mentioning before, it has been of concern to a lot of the people who have been before us about the interpretation of that, so you're not out on a limb by yourself on that one.

MR BASTIAN: No, the only reason we've used the language which we've been trying to use is in order to conduct a debate on economic grounds. I have used the term "labour-intensity" - I'm not an economist - but I do honour the fact that in the end the debate has to be debated in economic terms not emotive terms, and therefore I guess we've been a bit picky in the report where we believe it is making assertions that are unsubstantiated and we have very little confidence, I guess, that pointing to the bright light on the hill too far down the track and if we keep our fingers crossed and go for it in a competitive fashion we will get there. I just don't think we will.

MR COSGROVE: Thank you very much.

MR COSGROVE: Our next participant are some irrigators, Mr Caldwell and Mr MacPhillamy. Is that correct? Before we get under way we need each of you, for the purposes of our transcript, to identify yourselves and the capacities in which you are appearing.

MR CALDWELL: I'm Robert Caldwell and this is Prof Button.

MR COSGROVE: Robert, you're a private irrigator.

MR CALDWELL: Private irrigator.

MR COSGROVE: Prof Button is associated with which - - -

PROF BUTTON: I'm associated with the University of Canberra but my role here is working with people like Robert. I haven't worked with Robert in any financial capacity but for many years have worked with irrigators in water management issues right across Australia, so Robert has asked me to accompany him here and make some general comments in regard to principle, and he'll be talking about detail.

MR COSGROVE: That's perfectly okay.

MR CALDWELL: I'm really just here to table the documents, and they're all listed under here. I'll read it out. I've read your report and I don't think you understand the water situation. The New South Wales reforms are driven by the cap - well, national competition policy; NBDC cap and the DLWC. The DLWC is responsible for the New South Wales legislation and implementation. I'm really interested in this from my point of view and that's how I see it. I've tabled the original submission.

MR COSGROVE: Yes, we have that.

MR CALDWELL: That's the first one in the pile. The second one is the active locked-on users have lost half their allocation because of the cap and inclusion of sleeper licences. I'm not sure whether you understand all that but that's what the reality is on our river. The EPA and the DLWC - the Environmental Protection Agency - have quite a big influence over DLWC policy, so between both of them they plan to reduce water use by 10 per cent to force on-farm efficiency. All these departments are quite open in what they're saying they're going to do but I have a great question as to whether they really know what they're talking about.

The Nature Conservation Council, Tim Fischer, believes the DLWC will impose a further 10 per cent reduction to meet their call for a 20 per cent. In other words, they've done a deal with the government that they're going to try to reduce irrigation allocations by 20 per cent to improve efficiency. That's their agenda, I believe, and I believe the government is trying to do it. For me, my licence with a face value of 80 megalitres will only be good for 450 megalitres. In other words, that's the loss I've suffered in the last two years, and I'm quite upset about it. I will

have to halve my

productivity - that's what I've done. I've had to dispense with my farmhand and he just doesn't have a job any more.

IPART and DLWC are pricing on a full allocation. The Independent Pricing Tribunal are fully aware of this and yet they go along with it. I don't think they're very honest about it. IPART and DLWC are pricing on full allocation. They know that only half the allocation will be permitted to be used, and that's because of the cap. This doubles the cost per megalitre. IPART's attitude is that they're going to recover the money to pay for the running of the DLWC, basically, and they don't care how they get it; they've just got to get a certain amount of millions of dollars and they're going to achieve it.

Allocations are calculated on an annual basis after meeting environmental requirements and assessing remaining water in storage. That's the mathematical calculation they're using. Now, this is where I question the technical side of the whole matter. The hydrology of valley inflows are highly variable. Minimum inflows into Wyangala Dam - this is just to give you an example of what's happening - was 14,000 megalitres in 1982 and the maximum was 4 million megalitres in 1956, and that's probably a hundred-fold change - it's more than that.

Average valley inflows are 2.5 million megalitres. Diversions range from a quarter of a million to 420,000 megalitres and we're only diverting 11 to 19 per cent of the resource. Now, this is one of the key questions: is 11 or 19 per cent too much or not enough? Other rivers have more; they divert up to 40 per cent. So that is the question. We're just sifting through these; they've got numbers on them, all these supporting documents. Number 10, recent imposition of environmental flows: what they've done is because of the licence system under the previous - well, it's still current legislation - a licence was normally issued for 12 months. The allocation was issued for 12 months and so if you're going to reduce someone's allocation without compensating them or without tearing their licence in half the only way you can do it is to increase the environmental flows to the extent that there's not enough water in the dam so then they can say, "Well, we'll only give you a 50 per cent allocation." This is the driving force.

Recent imposition of environmental flows of 150,000 to 350,000 megalitres from Wyangala Dam will spoil the reliability of Wyangala Dam and reliability of allocations. In other words, that dam was constructed as a conservation dam only and these environmental flows are being manipulated to implement the cap policy. Prior to 1997 irrigators expected one year in a hundred with zero allocation. Now, they can expect 30 years in 100 years with a zero allocation. The University of Melbourne have worked that out. This is a loss of reliability and in my opinion if you have no income for a couple of years you'll probably be out of business. If you get no water that's about what it amounts to.

The yield from Wyangala Dam will be small - that's because of the environmental flows and the environmental flows may cause more harm than good. In other words, it may be detrimental leaving out 300,000 megalitres for in-stream

transmission. In other words, it never gets out of the river. It just carries on to the bottom. It might cause more damage down there than good. So I'm sure they don't understand what they're doing. All they're keen about is implementing the cap.

Contrary to your consumption based pricing - this is another issue - the pricing of water - in your thing here you talk about consumption based pricing. Well, the DLWC realise that in quite a few years they're going to have no allocations and then they'll have no income so contrary to your consumption based pricing water charges will still be billed, even when no water is delivered. In other words, I'm sure I'll be still getting a 2 or 3 thousand dollar bill and I won't receive one megalitre of water, and I think they want to have their cake and eat it. They want to take it away, give it to the environment, spoil the reliability and then charge me for their wages. I think it all should be privatised, actually.

The public good: an amount of water at least as large as diversions goes to the public good. This is unbillable and should not be charged to water users. Now, the attitude is: "We'll recover all the costs from the users." They ought to dip into government revenue if they want to - I'm sure you know what I'm talking about.

15: I am very concerned about the technical competence of all these bureaucratic policies and the physical consequences. The most obvious one is increasing physical consequences; increasing watertables and consequent salinity. The Lachlan river system is closed. In other words, all this 350,000 megalitres that goes down to the bottom just sits down there in a swamp, so if they're not very careful they may cause more harm than good.

Your suggestion of sinking funds - this is a side comment - is unwise. I believe the 1.1 million which was in the Lachlan River account has been ratted by the New South Wales government. In other words, they've just knocked it off and it's probably out at Homebush or somewhere right now. I don't think you can have sinking funds simply because you can't trust the accounting systems or the managers or whoever. I refer to your conceptual issues in pricing irrigation water. There's a copy here somewhere.

Number 17; it's the front page and it's worth reading and it talks about writing off the cost of dams because the government has paid for them long ago. They've probably recovered most of the money in taxation and if you overcharge for water you're going to cause more harm than good. Full cost recovery may not be appropriate if dam and on-farm capital expenditures are sunk. That's an economic debate, and I think just expecting to give the water charges a blank cheque all the time is not on. I've seen half my allocation vanish with no composition over the last two years, and I don't know how much more recent it has to be; that's a pretty short time span.

I'm amazed you don't understand the importance of keeping input costs and remaining internationally competitive. I went down to the supermarket on Saturday and bought some cans of tomatoes and because I used to be a tomato grower - the

factory managers used to do this to us every year or two. The Australian cans were 93 and 94 cents; the one made in Italy is 87 cents and the one from Thailand is 60 cents, 59 cents. So I'd say that all these cans are going to be imported pretty shortly. I'll now give over to Prof Button.

MR COSGROVE: Thank you.

PROF BUTTON: I'll just make some general comments about the issue of introducing the items of the Hilmer reforms competitive policy in the area of water when the market in which they're being introduced is already highly distorted and continues to be so. If I just go back some 10 or 15 years, essentially irrigation practice in Australia virtually did not exist. Most of the dams were constructed between the 1930s and the 1960s just really to employ day labour and there was no demand for them. Dams were initially unutilised.

I'll give you an example. The Keepit Dam was constructed and a couple of American cotton growers came out and said, "There's a dam there with near a million megalitres of water" and the New South Wales government had to actually encourage them by various ways and means to start using the water. It was an embarrassment. It didn't take too long before people realised the value of water and the potential productivity of water and it also didn't take too long before governments and, in particular in relation to water, it's an increasingly difficult problem because water basically - water policy and water management - is under the constitution a states rights issue and over the top of that the involvement of the states and their various policies - all the policies are attempted to be imposed. So there are some conflicts between the principles at federal level and the practice in terms of management of that water at state level.

It essentially didn't take too long before state governments realised the benefits to the public coffers of selling off the silver, as it were, and I have been on the record for years and years, warning against overallocation, but the history is in every river valley - in New South Wales at least and in most river valleys in eastern Australia. There have been massive overallocations of water - massive overallocations - to the extent of at least in the Gwydir Valley - I warned in the mid 70s, based on the practice, the experience in the valley to the south, which shares a common catchment with the Namoi, "Don't issue" - basically it has got the same climatic regime, the same median annual flows.

Copeton was built on the Gwydir River, twice as big as it should have been - it has only ever filled three times in its history - and twice as many licences were issued as were issued in the Namoi, and that situation has never been rectified, so when you are asking for a more competitive pricing policy to be introduced into an environment where, essentially, you have had a distortion and corruption in the market and that corruption has not been fixed, somebody has got to suffer.

Initially it was not a major issue that too many licences had been issued, but it didn't take too long before the uptake of those licences - a lot of licences were issued

and remain unused. State governments, particularly New South Wales, have been always averse to cancelling licences because they fear the legal consequences, but it didn't take too long before those licences began to be used in a much more substantial fashion and so we had a sudden upsurge from say the late 70s when, in most river valleys, less than 50 per cent of water licences were actually utilised - and I believe in the Lachlan Valley that is about the case now - to situations in, for example, the Gwydir Valley, where something like 97 per cent of all the licences are now utilised on a regular basis. So essentially in the face of overallocation of licences and failure to deal with that as the utilisation factor rose, supply reliability fell and, I believe, again the introduction of competitive pricing really doesn't take adequate cognisance of that overlicensing nor the decline in supply reliability as the uptake of licences continues to occur.

Then in the context of that, even before Hilmer came along but particularly since then, part of the competition policy has been not only increased pricing but policies of water trading and transferability, and that has basically had the effect of exacerbating the process where the last unutilised volumes of water now are being traded. They do migrate, yes, on economic principles, to the users with the highest marginal use or marginal value, but essentially that means that the supply reliability of the reigning land-holders in the valley continue to decline as you introduce these water trading measures.

Even today as state governments are struggling to deal with increased demands for water and, in particular, with respect to an increased demand by the green sector in a reservation environmental flow, state governments flatly refuse to deal with the issue of sleepers and dozers; that is, licences that are out there have never been utilised, which can now be traded - issued at, you know, tens or even hundreds - no, more than tens or hundreds of dollars - and now can enter in the market, having never established a value in terms of it having been used before, and then sell it off at - well, I have done a conservative valuation in the Gwydir Valley between 600 and 700 thousand dollars of unearned value, and governments refuse to deal with these sleepers and dozers.

Again, that's a further corruption of the market in that, as the competition for water increases and as water rights are traded and migrate to the highest value end users, the potential for a further decline in supply reliability in the face of increased prices is quite critical because these sleepers and dozers are not taken out of circulation, as it were. Essentially, individual land-holders - individual irrigators - are being asked to carry the full costs - not only financial but in terms of reduced supply reliability - of mistakes made by governments in the past - and continue to be made by governments.

In the context of the introduction of competition policy in respect of water use in Australia we have a situation where an increasing amount of water is being clawed back in the interests of environmental flows and environmental targets, and I'm not against that but I do have some quite critical observations to make in the way that is being done. But essentially what is happening is you are getting a smaller and

smaller

proportion of available resources available to off-stream users, or extractive users, who are being asked to pay more and more for water, while the non-extractive users, including reservation for environmental flows, are not being adequately charged or that that water is being under-valued or valued at - it doesn't come into the equation.

I guess that is a very, very brief overview of the kinds of conditions that have led to the current situation and I don't believe you can introduce the elements of a competition policy in respect - particularly the use of water and the pricing of water, without recognising the distortions that have existed by way of history in that market.

MR COSGROVE: Thank you. It certainly is a complex area and I, at least, may well not understand it fully and perhaps you can help me in that regard. This distortion, the historical distortion brought about by governments, would you say that's largely associated with the absence of clear property rights to water or not?

PROF BUTTON: Yes, that is another interesting element. It has only been in recent times - perhaps in the last five or 10 years, depending on which state you are looking at - that water rights have been unlocked from the land. An important element of the transferability - temporary transfers are now permanent transfers - was unlocking the water right from the land.

MR COSGROVE: Yes.

PROF BUTTON: That was seen as positive, initially, but it has negative consequences in that as soon as you unlock water from the land and allow it to be traded, to find it being picked up by users with the highest marginal value - you have all sorts of potential distortions arising from that, not the least of which is the dislocation of local communities when you find large volumes of water being traded away from that section or those reaches of the river where producers have fed the local economy, and that is a major issue.

One of the issues that has never been recognised, I believe, in the public arena is the potential threat to the livelihood of a single enterprise associated with unlocking those licences from the land. In particular, I am well aware of situations where the banks have now come in and identified that not only does the borrower have land on which a mortgage exists and repayments are due, but he has a separate entity which has substantial value - namely, a water right - which has been unlocked from the land and now can be stripped from the land and the land rendered unproductive, substantially lower valued, and you know we are well aware of some of these ploys of the banks historically and currently, but that is one thing that has happened as a consequence of water trading.

MR COSGROVE: Yes, I can see what you might call "social disruption" that can be associated with those changes but, on the other hand, it seems important from a national point of view that we do make the best use of the resources available to us and water is one of those resources - - -

PROF BUTTON: Yes.

MR COSGROVE: - - - and to lock it up in less productive uses would involve foregoing some possible additions to our wealth, wouldn't it?

PROF BUTTON: I have no objection to unlocking water from the land and then letting it to be traded and that means that the maximum - you know the highest value in return dollars per megalitre of water used is more likely to occur, but the negative consequences of that are decreased supply reliability to other productive users who have already invested substantial amounts of funds and find themselves with rights being substantially reduced and the supply reliability to them being substantially reduced and further reduced because of increased environmental restrictions, environmental demands, on top of them. So, if you like, the concept, the principle, behind unlocking water from the land and allowing it to be traded is all very fine but it has got to be the impact, the potential impact, on existing users who don't want to get into the water trading business - the potential impact on them and on the economy is substantially higher than people have recognised.

MR COSGROVE: Let me try to understand a bit more about this pricing of the existing licences. You said that the sleeper and dozer licences were essentially given away for a song.

PROF BUTTON: All irrigation licences before embargoes were imposed - in most river valleys in eastern Australia in the early 1980s all river licences were basically given away for a very low value.

MR COSGROVE: I see, right - they were issued.

PROF BUTTON: They were issued basically. You didn't pay for a licence; you just paid for the administrative cost of issuing a licence.

MR COSGROVE: So in other words, a person actively using a licence has not been financially disadvantaged relative to a person who has got a sleeper licence; they have essentially expended the same or a similar amount of money for both?

PROF BUTTON: For buying? For buying the licence?

MR COSGROVE: Yes, for obtaining the licence.

PROF BUTTON: Yes, but in terms of rendering the licence productive obviously the active user expended capital, putting in pumps, on-farm water storage to take water when it's available in high flows and carry it over; you know, it's those people who are genuine bona fide water users and who have invested capital - capitalised - to improve and increase the value of that water are now being penalised by the fact that there are people who have been issued water licences and who have sat on them and they've speculated on them, if you like. It has cost them nothing to do that and they are the ones to benefit under tradeable water rights and increased value of water

to

the detriment of those who have actually done the investment.

MR COSGROVE: And what is it that you would say is driving the increased value of water? Presumably, it is partly these environmental considerations which are leading to caps being put on the allocation of water for irrigation use?

PROF BUTTON: Yes.

MR COSGROVE: Is there more to it than that?

PROF BUTTON: The fact that whenever you get a commodity such as water in short supply - I mean, there is limited volume of water and whenever that occurs and an increased demand - you know, in response to a market opportunity for production of a particular commodity, then obviously that would drive the price of water up. I have been particularly associated with the cotton industry, which I think besides the vines industry - the wine industry - is perhaps the best way to turn a megalitre of water into export dollars for the country, so when you have got those export market opportunities for a commodity such as cotton, then clearly they have the capacity to pay more for water and drive the price of water up, at least in a local valley situation.

But I think on the other side, as water reliability declines then people are being prepared to pay more and more for just that marginal last increment of water required to bring the crop in because, you know, you start off a season and you start watering a crop and you get to the end because of a situation where you actually realise less than your entitlement, on the face of your licence, and you're faced with a situation where - what do you do? You either let the crop wither or go out in the marketplace and pay extraordinarily high prices for that last increment of water to bring that crop in, and so a consequence of overallocation, overlicensing, increased utilisation of licences, failure to take licences out of the pot, allowing them to be traded, is decreased supplier reliability and therefore increased prices at the margins.

MR COSGROVE: Yes. The impression I have is that governments in the past have created a situation in which it seems they undervalued water and so people who have been using that water have been paying less than the cost of its provision. Part of that is the environmental story. I have to say straight up front that we can't arbitrate on that in this inquiry. It's a much bigger issue than that. So the normal market pressures applying to water are seeming to be raising its price and, as any significant change in price in all sorts of markets, that will have some significant consequences for people who are using water.

So the central question, I think, becomes whether you use what is, in an admittedly difficult area, the best indication of the most appropriate price of that product or not and, if you do raise the price of water because you think it needs to go up to equilibrated supply with the various demands upon it, then there will be some people who are going to have to adjust or go out of business or change the style of their production. How does that all sit with what Robert was outlining to us in terms of how the New South Wales government, in this case, has been going about things?

PROF BUTTON: You asked a question before about what are the elements that drive the price of water up. You have alluded to just the market economic ones. I think there are two other elements that are driving the price of water up: that is, the bureaucratic cost associated with administering water - - -

MR COSGROVE: So there is inefficiency in the - - -

PROF BUTTON: Inefficiencies, yes.

MR COSGROVE: - - - conduct of the allocation system and so forth?

PROF BUTTON: And the example Robert gave of in the Lachlan Valley is not an unusual one now where they're faced with 30 years in a hundred of getting a zero allocation and yet having to pay several thousand dollars for water that's not delivered, quite simply because you have got to meet the administrative costs of maintaining a bureaucracy that can't deliver the water to you. I believe, if we're talking about the introduction of competition policy in water, we don't just talk about price and mechanisms to allow the water to be traded; I think you go the full hog in the bureaucratic sense - and I have been advocating this for a long while - that the management of water should be taken out of the hands of government.

It should be managed under pure market principles by local valley authorities who will not charge themselves or charge their clients when they can't deliver the goods. The IPART hearings that happen every year or so in respect to the value of water are almost totally preoccupied with bureaucratic inefficiency arguments and the issue of what is the base cost of water which must be borne whether the water is there or not. So that is the bureaucratic element that, if you like, pumps the price of water up.

MR COSGROVE: Is this because there's some sort of two-part tariff or not? In other words, do the users pay a fixed charge for the maintenance of the headworks and the canals and so on and then they pay also a second part for the actual water they use?

PROF BUTTON: There are more parts than that. I mean, I'm not an irrigator and so I therefore don't pay the irrigator bills but there is an element of maintenance of headworks and the operating side. There's an element then of having to pay all the salaries of the bureaucrats who, even in drought, enjoy a good feed while the irrigators can't. Then, on top of that, there is a water use charge - an extraction charge - on a per megalitre basis and then, on top of that, now there are environmental charges where irrigators are being asked to bear, increasingly, the cost of the environmental consequences or the cost consequences of upstream catchment management as well as downstream environmental reservations.

We're all aware of increased pressures to reserve more and more of the environmental flows to environment. In the Lachlan Valley that has gone to the

extreme to the stage now where the environmental flow reservation exceeds the volume by far that's available for extraction and that is not a good thing in the Lachlan because the Lachlan historically never runs out the bottom, and now we are going to see environmental damage associated with those environmental reservations which are being argued very strongly by those with those interests in the community. I'm concerned, quite frankly, that there is no evidence after 20 years of study by environmental ecologists as to the timing or the volume of water required in a stream-specific basis to support their arguments for these increased flow reservations.

MR COSGROVE: In the Lachlan - are you talking specifically there - or more generally?

PROF BUTTON: In the Lachlan in particular, but every river valley. I'm personally associated with the CRC for Freshwater Ecology at the University of Canberra. I'm regarded as a little too red because I associate with the water users where the majority - the objective of the CRC is to look at the ecological requirements of rivers. I have personally been involved in several river valleys where I have been asked to look at the consequences of a development proposal and the - I have just lost my train of thought there for a moment. What was the question?

MR COSGROVE: You were saying you were involved in the work of a number of river valleys.

PROF BUTTON: Yes. The increased demand for environmental reservations can never, and has never been able to by my fellow scientists, be justified in terms of scientific investigation or study that says, "This reach of river requires this volume of water to be reserved to keep it alive under these flow conditions." So, if you like, the price of water is being driven up in the marketplace, not just by the value that you can generate in terms of producing a final good, but it is being driven up by shortages, by water trading, by inaction of government to rectify problems of the past and increasing demands for more and more water to be reserved for other purposes that don't even have a productive value assigned to them.

MR BRAITHWAITE: Getting a handle on New South Wales water is not easy.

PROF BUTTON: No, it's not. It's very complex.

MR BRAITHWAITE: I'm trying to get something in my own mind. The Wyangala Dam, is that a state structure?

MR CALDWELL: A major storage, yes.

MR BRAITHWAITE: Maintained by them? They maintain the head water? How do you draw water from it? Is it by channel or pump from it?

MR CALDWELL: Yes, by electric pumps out of the river up onto my paddock.

MR BRAITHWAITE: You pay a usage charge and your complaint is that your usage is also the cost of storing that water for environmental flows.

MR CALDWELL: There is a list of charges here. Number 7 - it has got a fixed component and a usage component.

MR BRAITHWAITE: That's basically part of your argument. Let's have a look at seven then.

MR CALDWELL: Number 7, about halfway through. It has got "state water" up on the top. What really put the cat among the pigeons with this whole system was, if the average inflow into Wyangala Dam is - sorry, the median inflow which is a bit below the average - if it's five or six hundred thousand and you have got transmission losses operating in the river of 300,000 and then someone like Penny Knights comes along and says, "We're going to take out another two or three hundred thousand for environmental purposes," you have virtually got nothing left for the irrigators and they're doing it on purpose to try and drive the price of water up so that it's competitively priced.

They have got no idea where the environmental flows are going to go and they're not paying for them. They're just saying, "We're taking it and we're looking after the environment," and that's why Prof Button is here - because I'm a bit worried that the water may do more harm than good.

MR BRAITHWAITE: So could I come back to this schedule - a 99-2000 fixed charge - the high is 461. That's the fixed charge.

MR CALDWELL: That's the high security. I think you should be looking at the 307.

MR BRAITHWAITE: And so low security 307.

MR CALDWELL: Yes.

MR BRAITHWAITE: But what you're saying; that is a fixed charge which is a charge for the bureaucracy.

MR CALDWELL: That's correct.

PROF BUTTON: Under any circumstances of delivery of volume, yes.

MR BRAITHWAITE: And a charge for holding the environmental water and letting it through.

MR CALDWELL: I don't think - - -

MR BRAITHWAITE: Would that be part of your fixed charge?

MR CALDWELL: They need a certain amount of money each year to run their office down there and they say we're going to have - - -

MR COSGROVE: And the water storage system.

MR CALDWELL: Yes - all their costs, right? I don't know how they split it up. But they decided that they had a usage charge about five years ago - usage only - so if you used it, you paid for it; and if you didn't use any, you didn't have a water bill, basically. After that they decided that they're going to have a fixed charge so they have introduced a fixed charge. The inequity in this one is that because our river system is - the cap is going to virtually halve our allocations, you can almost double that fixed charge. Instead of calling it \$3.07 it should be \$6.14 on the megalitres because - - -

MR COSGROVE: That you use.

PROF BUTTON: Because your supplier reliability, on average, is now 50 per cent.

MR CALDWELL: Because of the cap. The cap is in there and they're not going to give me more than a 50 per cent allocation. It doesn't matter whether the dam is spilling or what's happening. That, I feel, is an injustice by the IPART's attitude is, "We're just going to have full cost recovery and you guys are going to wear it." They're quite open about that.

MR BRAITHWAITE: I think I understand that now and I think my original question covers that in the affirmative. When you get your licence, is that an annual event?

MR CALDWELL: Five years it lasts. You pay \$800 and you get it for five years.

MR BRAITHWAITE: What do you pay for that licence now? Still practically nothing?

MR CALDWELL: \$850 to renew it every five years.

MR BRAITHWAITE: What was the government's reluctance to cancel that licence if it was a five-year licence?

MR CALDWELL: I think every time they went out to cancel one, some bloke would dream up an excuse why not to cancel it. He would say, "Look, I'm going to lay it out next year" or "use it next year."

MR BRAITHWAITE: The definite point there that you make is that after three years of non-use it should be cancelled.

MR CALDWELL: That's correct. What they should have done - because these dams were only not being very well utilised - they just kept issuing more licences. What they should have said was, "We'll cancel a few and then we'll start reissuing them." They didn't do that.

PROF BUTTON: Even now, on river valleys where water use rates and uptake of licences is almost 100 per cent, the few licences that are left available to be traded - there's been arguments put to the government that they shouldn't be allowed to be traded if they haven't been utilised and even if they are allowed to be traded - first of all, those who have water that could trade - if they don't use, they should lose. The governments are reluctant to take that position because they regard that as a property right. They're fearful at law that by taking that right away they'll be subject to challenge at law.

Propositions have been put to government that one way in which they may solve the initial overlicensing problems and solve the resulting problem of decline in supply and reliability - if you allow those water licences to be traded and go towards particularly high value end users where they're going to be required every year, and the consequence of that on people - on low value is going to be, you know, even reduced supply and reliability, then for every two megalitres of water that's traded one should be sent back to the pot never to be allocated again; in other words, those who want to enter into a market to buy high price water, they should recognise the value of that water and recognise the necessity with government to resolve the problems that are being caused from overlicensing in the past and allow half to go back to the pot.

MR BRAITHWAITE: How secure are these rights? Because we got the message in an earlier hearing that what the government hadn't given them is a permanent right to be able to deal with that, use that as a tradeable item. They're still trading it, but they seem to feel as though the government had not yet separated that right from the land.

PROF BUTTON: No, they have. In practice - and I stand to be corrected, but I'm associated with some large corporates who are in the business of trading water rights - there's a distinction between temporary and permanent transfers. Temporary transfers for the most part, depending on which river valley you're dealing with - you're allowed to transfer that water either in as a user or out as a person who doesn't want to use for between three and five years, and then you're not allowed to do that transfer there and thereafter. But there are permanent transfers now available and they're not totally unfettered and unrestricted. Generally there is some degree of restrictions in terms of which reach you're able to trade down or up.

Those transfers are taking place now, permanent transfers, unlocking the water from the land. A lot of large corporate agribusinesses - and not so large ones - for example, they go into the market, find where those licences that are underutilised or unutilised, identify where they are, buy the property, strip the licence from the land

and then sell the property as a dry land property. So there's a whole range of mechanisms that are in place in these water trading, water transfer situations.

MR BRAITHWAITE: So the government recognises it as a real right and a transferable right. It has the government backing. The right has the government backing, has it?

MR COSGROVE: They want you to have right rights because you've asked for them, and on the other hand they're saying, "But we can take out environmental flows and spoil your reliability as we please."

MR BRAITHWAITE: Yes. I'm only asking the question because when we spoke to another group they gave us the impression that the state had not moved to giving a permanent water right, and that's what they wanted desperately. So the Lachlan system is different to the other system we're talking about.

PROF BUTTON: I think it's all the - - -

MR BRAITHWAITE: The north New South Wales systems.

MR COSGROVE: So there are just renewable licences, nothing more.

PROF BUTTON: In New South Wales they still are renewable licences, and even if you buy a renewable licence under a permanent transfer there is no such thing as permanent access to those rights. They have to be bought, renewed.

MR COSGROVE: Like a driver's licence.

PROF BUTTON: Just like a driver's licence.

MR BRAITHWAITE: So that is really the point.

PROF BUTTON: That is right.

MR BRAITHWAITE: It's a renewable right.

PROF BUTTON: Yes.

MR BRAITHWAITE: Would you want that right to be more definite, that it was a permanent right?

MR CALDWELL: If you can pin down the reliability, but I don't think you can. I don't think the government want to give that undertaking. If they want some more water they just think they can come along and take it, and they will, so I - - -

MR BRAITHWAITE: When they trade those rights, recognising that your right is

only of half the amount of the face value of that right, at what prices do these trade? It is recognised in the trade that 300 megalitres is only worth 150, or something like that?

PROF BUTTON: It depends very much on which river valley and what commodities you're producing, but I've been involved in trades in the wider valley where a 972-megalitre licence trades for between half and three-quarters of a million dollars, and that's just a once-only payment and of course you've got to pay your fixed and usage charges thereafter.

MR BRAITHWAITE: That's an enormous amount of profit from a licence that's only worth 800 bucks, isn't it?

PROF BUTTON: That originally was issued at about 15 bucks.

MR CALDWELL: Another little thing here that may not occur to you, but on the last page - I think it's page 20 - you're talking about separating the water rates from the land, and the rates, the value in general, puts the rating - included in the rating are the value of the irrigation licence. So if you can separate the irrigation licence from the land then you should be able to devalue your farm by at least 50 or 60 per cent.

MR BRAITHWAITE: That won't happen though, will it?

MR CALDWELL: I'm off the Land Environment - - -

MR BRAITHWAITE: I'm familiar with another system which is similar, which they call assignment. You have land on which you've got the permission to dry crop, and that assignment can transfer from one block of land to another, but what remains on the block of land, there's no such thing as an unimproved value of that land. That doesn't include the assignment.

MR CALDWELL: I'm rated on the value of my farm. If I transfer the water away from it - - -

MR BRAITHWAITE: If at that stage - - -

MR CALDWELL: Then the farm's value - - -

MR BRAITHWAITE: At a lot less - - -

MR CALDWELL: It must be two separate entities surely.

MR BRAITHWAITE: It's not the same in the other situation I mentioned, but then the value would go to the land that it goes onto I suppose.

PROF BUTTON: Back to your comment a moment ago about have we ever

reached the stage of a permanent water right attaching to the right to hold and not to the land, we probably won't reach that stage until the current round of exploration of alternative methods of allocating volume have been fully explored. Up until now in general in most systems you had a water right for example of 972 megalitres on the north part of the state; the southern part of the state is totally different kettle of fish. Generally you were able to use at least 120 or 140 per cent of your entitlement each year. We won't go into that, but basically it's based on the history of irrigation in southern New South Wales being predominantly government sponsored and northern New South Wales being privately sponsored after capital headworks have been supplied by government.

But essentially up till now a given number of irrigators at the start of the year need to be supplied with water. The state government looks at the volume that is in the dam and says, "We're going to allow a certain amount for transmission losses and stock and domestic and whatever," and then announces an allocation for the season and revises that allocation upwards based on progress of inflows during the season. It never is revised downwards, because there are legal consequences of that, of giving something and taking it away, even though it's a seasonal allocation, not a water right as it were. So you might start off with a 20 per cent allocation based on a very low dam situation and you may end up with 100 per cent allocation at the end of the season, and then you can supplement that off with off-allocation flows where water actually spills over the top of the dam or runs in unregulated downstream. There is an increased resistance to unfettered access to that off-allocation flows in the interests of environment.

But in various valleys there are alternatives being trialled to look at, for example, the consequences and the rewards available if you do not use your full allocation. If you are efficient, what are the consequences of the efficiency? What are the rewards? In some valleys carry-over has been allowed, so you could carry over up to 50 per cent of your allocation or up to 100 per cent of your allocation if you decide to be efficient and leave your unused water in the dam, so your risk is minimised in the subsequent year.

Now, there are limits to that as a function of the combined capacity. You're still in the region of supply and demand, but we're now seeing a move towards alternative situations, one of which is described as capacity sharing, where essentially a fixed volume of water in storage is calculated - or a fixed capacity of dam - and then an allowance is made for transmission licence and evaporation and town water and stock and domestic, and then the residual is then apportioned between high and low users as an indexed share. So you might get a 1 per cent share, for example, of the available water and then, depending on whatever situation exists in following years, you are entitled to that index of that volume of water. I don't think we'll ever get to the situation where a water right will ever be a permanent water right because nobody could ever guarantee that that right can be satisfied, depending on seasonal conditions.

MR COSGROVE: Are they not present in Victoria?

PROF BUTTON: I must admit I'm not fully aware of the situation in Victoria. It's probably more likely in Victoria where supply reliability off catchments by virtue of the climatic circumstances is such that your variability of flows is less.

MR COSGROVE: Yes.

PROF BUTTON: But I would be surprised if it's gone that far in Victoria, because the characteristics of all Australian streams - I mean, we could talk about economics till the cows come home, but the reality of water use in this country is that supply reliability and flows are among the highest in the world, and so how can you allow a free market situation to exist in an environment where the average means absolutely nothing; average flows mean nothing.

MR COSGROVE: It would be priced in as a risk factor.

PROF BUTTON: Yes.

MR COSGROVE: Just as people price forward in highly volatile markets for many commodities. Robert, could you tell me what proportion of your total production costs would be accounted for by water?

MR CALDWELL: Water charges?

MR COSGROVE: The cost of water, yes.

MR CALDWELL: At present I would think 5000 out of about 150,000, 3 per cent.

MR COSGROVE: 3 per cent, good.

MR CALDWELL: 3 and 4 per cent probably.

MR COSGROVE: It doesn't seem a lot.

MR CALDWELL: I'm worried about the reliability. If I don't get the water for 30 years out of a hundred - - -

MR COSGROVE: That's the conservative bottom price.

MR CALDWELL: Well, it is at the present, yes. That and the fact that if I've got a piece of paper that's worth hundreds of thousands of dollars and then they've just decided to come along and cut it in half, that's pretty upsetting, and I just - they're not prepared to - the water rights in Victoria, normally it was based on - in New South Wales the 972 was six megalitres a hectare basically on that. If you wanted to irrigate a hectare of your country they'd give you six megalitres; in Victoria they'd only give you three. They'd say, "There's your water right for three, and then you can

have

sales water for another three megalitres a hectare probably." So there was more reliability on the water right, and then the sales was more - - -

PROF BUTTON: It's always very impressive to actually quote what is the cost of water and how that factors into, in a relative sense, the total cost of production. That could be entirely misleading, and I'll give you an example. If you go to the Namoi or the Gwydir, which you're surprised if it's any different, a bit different lower, but say the Namoi. The combined fixed and usage charge per megalitre is somewhere in nine or 10 dollars a megalitre. Now, nine or 10 dollars a megalitre compared to the total cost of production of \$1900 a hectare is very, very small, but we do a calculation - you need something like seven megalitres a hectare to raise a crop of cotton, which is a high value crop, so that's \$70; \$70 out of \$1900 is a very, very small proportion.

But the reality is you can't just compare that to, say, Murrumbidgee water - this is pumped water, isn't it - where it's delivered free to the gate. You don't have to lift it; it's under gravity. The actual costs of paying for the water when you have to lift it bear no relationship relatively to the costs of actually lifting it, and the electricity charge or the diesel charge and the installation of the pumps or whatever, so the actual delivered cost to the land-holder is substantially higher. So when you talk about the price of water, it's not delivered the same way; it just doesn't fall on people. It either has to be lifted onto them, and groundwater becomes even - it's even more significant. The cost of lifting a megalitre out of the ground to irrigate a crop is even substantially higher.

So I think price of water, when you're talking about competition principles, price of water as a million litres in a megalitre, it's not just the price of the good itself. It's the way in which that good is delivered to the farm and recognising those kinds of differentials.

MR COSGROVE: I understand the sense of frustration Robert must feel when governments take arbitrary decisions that have a significant effect on your livelihood. I'm afraid when governments are running things that tends to often be the case.

PROF BUTTON: Yes.

MR COSGROVE: Apart from that, is there anything special about water that should lead people to expect other than that its price will change, probably increase? Businesses all around the country have costs which are, at least in price per unit terms, often outside their control. Something might happen, for example, even in a city area which raises the wages of workers. A big company might come in, hire a lot of people and other business people using labour might just have to pay more to retain their staff. Is there anything specially different about water from that point of view?

PROF BUTTON: I think there is. Unless I'm mistaken, the people I work with in the water industry do not object to paying more for water. There is no objection and there is a recognition that the price of water is going to go up. What people do object

to is the way in which the price of that water in a market place - in a pure market

place - in a normal supply and demand situation the price of water will be in proportion to the demand for it. If there's lack of water the price will go up. Now, you can't have a situation where the government is actually manipulating the market - deliberately in the past - and continually now, by eroding water rights, by increased and unfettered access for environmental purposes. You are jacking the water price up artificially.

I will give you an example. In the ACT here, if Kate Carnell decides to generate more money for the coffers she just, on the next auction, releases less land to be auctioned. That's exactly the situation that you have with water; the only difference is, I guess - no, there's no difference. The land is the crown here; water in Australia is the crown's.

MR COSGROVE: But there has to be some administrative agency to effectively allocate water, I would have thought, unless you go for a complete open slather, and say, "I can pump anything out of the river onto my property and to hell with anybody's interests." So what authority is likely to be an improvement on a government process?

PROF BUTTON: I agree that ultimately if you allow water - again, this is the point I'd like to make to you, when you're talking about competition policy and the use of open market mechanisms to determine ultimately price of water and who the water goes to, essentially an open-slather approach is not in the interests of anybody. In respect of water, a situation where you take the view that every drop of rain that falls on you is yours, nobody else would get any. So, yes, water as a public good has to be controlled in the interests of the public.

MR COSGROVE: Isn't that what governments are supposed to be in place to do? They make mistakes, I know.

PROF BUTTON: Yes, but I think government has a responsibility to set the guidelines; set the framework. But where government gets in the road of business at the local level and makes determinations, often arbitrary, on an event basis - this is what happens in the irrigation industry - despite all your entitlements they can say, "Well, this particular event, you're not allowed to use. You've got to let it go past." Now, you've got a bureaucracy gone mad with respect to water where, despite the broad settings, which I think the industry has no objection against, you have constant harassment, changing of the goalposts on a day-to-day basis, event-by-event basis and what water users are complaining about is not against the free market in respect of water but the manipulation of that market by government.

The issue is not one of price. The issue is one of certainty and security. If irrigators knew for certain that on average they were going to get 50 per cent supply reliability they would be able to factor that into their cost of production, but the way things are going the situation has declined rapidly in the Lachlan from 100 per cent reliability to the last couple of years; to 50 per cent and there's no telling where it's going to stop. I know it's beyond your brief to referee the issues of environmental

conservation or whatever but the consequences of increased reservation away from productive use of water is going to be environmental degradation and devastation.

One of my tasks, my role - I'm the managing director of a satellite monitoring company and I just happen to have monitored the Kumbung swamp at the lower end of the Lachlan River over the last 25 years and been alarmed at the environmental degradation associated with that through overallocation of water into that system.

MR COSGROVE: Can I come back to some of the principles that underlay the COAG water reforms. I take it from what you are just saying that there's no objection to water authorities, be they departments or something else, seeking to recover from users, and any other beneficiaries, the costs they incur in maintaining and refurbishing water storages, head works for offtake, and that they should put in place clear property rights.

MR CALDWELL: I think they're very reluctant.

MR COSGROVE: They may be reluctant but you wouldn't have any trouble with - - -

MR CALDWELL: I'd like to have water rights but I can't see how they won't be manipulated as they please - that's my fear -and I don't think they want to give them so it's wishful thinking.

MR COSGROVE: In your case, Robert, once we get away from the water storage itself and the point of offtake, are you part of a group of irrigators who meet the costs of the channels or what have you?

MR CALDWELL: No, all my channels are on my farm. I have river frontage so I just pump the water up to the top of the bank.

MR COSGROVE: So you're self-contained from that point.

MR CALDWELL: That's correct. I'm a minimal - - -

PROF BUTTON: There are groups of irrigators off-river in places like the Macquarie Valley who not only bear the water supply charge from government but they bear channel - - -

MR COSGROVE: Yes, the cost of maintaining channels.

PROF BUTTON: Internally themselves.

MR COSGROVE: Again, if there was a system in place that meant that those particular irrigators were asked to pay the costs of maintaining and refurbishing those channels - - -

PROF BUTTON: That too is okay.

MR COSGROVE: It seems a problem.

MR CALDWELL: On these privatised schemes they pay it. They just meter it at the river bank and all the other costs are on them.

MR COSGROVE: So your concerns are principally about the allocation of water issue and what you see as pretty poor governmental processes.

MR CALDWELL: Well, the property rights. The arbitrary manipulation of the whole thing by the environments - they're using the environment allocations not for the environment but to force market trading and, really, that's to comply with your rules.

MR COSGROVE: They're not our rules, I'm afraid.

MR CALDWELL: Well, the tranche payments of 6 or 8 hundred million to the New South Wales government. They don't want to fall foul of that and they're going to implement them and they're probably in favour of it anyway, but they're quite happy to pass the buck to the national competition policy. There are so many faults in there that are injustices - are what I call it, to me, one of the active users. That's why I'm here.

MR COSGROVE: That seems to turn back again to the environmental debate, doesn't it? I guess the state government and maybe the governments at large in the COAG context, when these policies were agreed to, did take a view, rightly or wrongly, that there were some environmental needs that they wanted to attend to and that would inevitably mean that the price of water would rise for irrigators.

PROF BUTTON: I guess ultimately in any walk of life, people are not worried about what they know is coming at them. It's what they don't know. It's the lack of security, lack of capacity to make one's own decision and realise the consequences of it. I think it's fair to say in New South Wales, and I think in every state now - we know in Australia this is the driest continent on earth. We know basically all the water rights are taken up. There's an embargo on any new licenses being issued in any river of New South Wales. There's an embargo which says there were too many licenses. It's an acknowledgment too many were issued initially.

We're in this situation where essentially we have a state government department in every state government in charge of selling of the silver. State water resource agencies were set up - initially they had a prime function. They had a capital works function to build head works storages and that was taken away from - in New South Wales it's the Public Works Department. So that arm got lost from them. When, in the 1980s, the function of issuing licences was lost to them because of the imposition of embargoes, essentially we still have a bureaucracy there which many would argue is unnecessary to protect the environment because there are

environment departments

such as the EPA and whatever.

So irrigators, in actual fact, are complaining in two respects: (1) the high bureaucratic price of water, or the high component of water charges that's due to an overloaded bureaucracy and a duality of bureaucracy that's not required; the second element relates to how that bureaucracy manipulates the available supply of water and constantly erodes that, even to the extent now where, as a result of, in New South Wales, the ministerial water reforms that have characterised the last couple of years, has resulted in river management committees making decisions about how the water is to be allocated and reserved for environment, etcetera. Once again, that system is corrupt. Again, it's beyond your situation to control that.

Essentially we have river management committees with memberships of around 15, government dominated. The actual irrigators comprise between two and three and five - five in Lachlan's case - of that group of 15, and you have a National Parks and Wildlife, and your Fisheries officer and EPA and Land Water Conservation and the Department of Land and Water acts as the technical adviser to those, so they basically bring about whatever mechanisms they like and whatever rules, which means that the supply reliability and the amount of water is less and less and therefore driving the price of water up for those who want to stay in the water market and survive. The continuing story of corruption of the market continues.

MR COSGROVE: It may have been a corrupted situation but one couldn't have expected it to continue to operate irrigation systems on the basis of full community funding, which I think was pretty much what we had.

PROF BUTTON: No. Absolutely, yes.

MR COSGROVE: So there's this attempt on the part of governments to say there should be a system in which the users of those investments pay for them.

PROF BUTTON: Yes.

MR COSGROVE: There are significant debates still going on about how you handle sunk costs of existing assets and so on but apart from that that is inevitably going to involve an adjustment; a big adjustment perhaps for some people who have been receiving water at prices which some other people have been substantially contributing to the cost of.

PROF BUTTON: I don't think you'll find any objection in the marketplace in rural Australia to paying a fair price for water, but when price is highly correlated to reliability and reliability is manipulated that's where the objection comes and the objection comes in respect of not knowing what the risk is. I don't think water pricing on its own is the issue. It's the relationship between price and supply, and when the market is manipulated or corrupted - whatever word you like - then you are not in control of your own destiny. You can factor in whatever charge you like, as long as people know it and know the rules of the game under which they would have

to pay

that. It's when they go into a season and they really don't know what's going to be available to them and yet they still have to keep paying.

MR COSGROVE: Is that your view too, Robert? If, say in the past, because taxpayers were meeting a significant part of the costs of the system being used you then had that taxpayer assistance taken away and your water costs went up 1000 to 5000, whatever it was, that - - -

MR CALDWELL: I think there are two issues here. First of all, there's the actual water rate. In America, I think it's minimal, in that it was a first in, first served thing. The person who got their rights first got the right and the next person was behind them and that's the way it worked. Out here it all rests with the government. The trouble is that if you sunk hundreds of thousands of dollars into land forming and on-farm works and suddenly find that you've only got half your water, they're virtually taking half of it away without compensation in my opinion. That's why I'm upset about it. Really, what I'm even more upset about is the unsoundness of the environmental quantities. I have said it before, they're trying to manipulate the market and they have not really got the environment at heart. I just don't know. They are just carrying out the national competition policy and that's why they're doing it.

We've considered the Equity Court as far as what's happening. We'd probably just waste a lot of money and wouldn't win in the end. The productivity is going to do down, I think, for no good reason. You don't seem to understand that the variability of supply is what is catching all these. It would be all right if you had a guaranteed supply and you could say, "All right, we'll charge you \$10 a megalitre," or whatever it is. Then I'll pay it and I'll get the water. But that's not the case. If I've got to survive three years or five years with no allocation and all my income comes from irrigated production, I've got nowhere to go, I'm just out of business.

I don't think they understand that. I don't think anyone has worked that out. Yet they talk about gross margins and linear programming and all this stuff to work out the profitability but they don't include the overhead costs of the farm so they're forgetting that people have got to live and pay to eat.

MR BRAITHWAITE: When the bill comes to you for the fixed charge, how transparent is that? How does the government indicate to you that this charge is for this amount? Do they do that?

MR CALDWELL: On this state water bill?

MR BRAITHWAITE: Yes.

MR CALDWELL: That's it. I got that in the mail about two weeks ago.

MR BRAITHWAITE: So they don't explain to you what that \$3.07 is meant to cover by way of fixed charges?

MR CALDWELL: IPART have got a great list of so much for management and so much for - - -

MR BRAITHWAITE: Is that available?

MR CALDWELL: Yes. IPART, New South Wales, independent pricing tribunal, yes.

MR BRAITHWAITE: So that's quite transparent?

MR CALDWELL: They've tried. They've forced the DLWC to reveal all its costs and they've tried, but it's a massive job, as you can imagine.

MR BRAITHWAITE: How many of these rights are traded on an average?

MR CALDWELL: Permanently?

MR BRAITHWAITE: They would be permanent transfers, wouldn't they?

PROF BUTTON: It's a complex function of what the commodity prices are in the year. I'll go to cotton again. Last year they were \$600 a bale, this year they're \$350 and you can guarantee there'll be no water traded on a temporary basis. While in actual fact it may well be that this year because the value of water will go down, because the demand won't be quite as strong, you may see more permanent transfers because the irrigator who is in for the long haul might see this as an opportunity to pick up some more rights. It's fairly complex, depending not only on what's available and the season, but its commodity price effect as well.

MR BRAITHWAITE: So you could transfer a right for 12 months.

PROF BUTTON: Yes. Temporary transfer, that's for one season, two seasons, three seasons, yes.

MR BRAITHWAITE: So the permanent transfer is not a regular thing.

PROF BUTTON: A permanent transfer is where the right goes to you and then the renewal of the licence comes out to you every five years.

MR CALDWELL: What's happening is that the marketplace normally is higher than the water charge here.

PROF BUTTON: A lot higher.

MR CALDWELL: That's why the permanent licences have got a value of \$350 a megalitre or something on the Lachlan, about 800 or 1000 up at the Moree. But what's happened on the Lachlan this year because the usage was only about

40 per cent, there was a lot of water forfeited and it just got thrown back in the pool at the end of June. If you tried to sell water in May or June, it wasn't worth a cent. You couldn't get any money for it.

MR BRAITHWAITE: So it's as flexible as that, or as volatile as that?

MR CALDWELL: As volatile as that, and it goes up to \$150 permanent, temporary.

MR BRAITHWAITE: So with your property, if you were to borrow money, how would your bank view your water right?

MR CALDWELL: I think they'd value it at about \$350 for every megalitre. But if I'm only going to get 50 per cent of that, that's really saying it's worth 700 for every megalitre that I'm eventually going to get. The marketplace doesn't realise that yet but that's what I think the situation is.

MR BRAITHWAITE: Your proposition, professor, about every time a right is traded that one-half is forfeited, how far have you taken that suggestion?

PROF BUTTON: Not in an official capacity.

MR CALDWELL: That used to be in force until a couple of years ago on the Lachlan River.

PROF BUTTON: Did it?

MR CALDWELL: Yes. If you wanted to sell water, you lost 30 per cent of the incoming buy. If you had 100 megalitres to sell, you'd sell it for \$30,000 or something. The incoming buyer would pay the \$30,000 and he'd only get 70 megalitres.

MR BRAITHWAITE: There's no compensation for that loss?

PROF BUTTON: No. You know what you're buying. You're buying that amount less, yes.

MR BRAITHWAITE: Would the same proposition be available not only on trade, but on a renewal of a licence? In order to get it back to a reasonable thing, when you came to renew it in five years' time, instead of renewing two, you're only given a licence for one. Is that a proposition?

PROF BUTTON: You'd have to be up for compensation. I would support that notion for those who are up for renewal who have not used. In other words, you've held the licence, you haven't used it for the last three years and if you wish it to be renewed, because the government is anxious to avoid legal prosecution it must renew it - or it has - then perhaps you should be penalised for not using. But that would

have the consequence of forcing those licences into the market, reducing supply reliability. The general principle, I believe, is that sleepers and dozers should be relinquished. I think that's a very very important initiative to, if you like, put a lid on this over-allocation that continues from previous history. We're talking about trading water rights that have never been used, against trading water rights which have been used for a low value up to a higher value.

I'm all in favour of water, once it has been used as an entitlement, migrating to higher and higher levels. That's a very good economic principle. You should extract the maximum you can for the use of that one megalitre. What I am dead against is people taking a water right, never using it, sitting on it and speculating. That should not be allowed in a situation where there is a gross shortage of water and a great lack of supply reliability.

MR BRAITHWAITE: But that horse has got away, hasn't it? It has bolted, it's out the front gate.

PROF BUTTON: No, the horse hasn't got away. If you've allocated a licence and the licence is out there and has never been used, cancel it.

MR BRAITHWAITE: But certainly within the last two or three years, those dozer licences would have done something to build up their right in the value of that right, wouldn't they?

PROF BUTTON: No, there are a lot of licences sitting out there, throughout New South Wales - - -

MR BRAITHWAITE: They better not get a transcript of this meeting then.

PROF BUTTON: - - - that have never ever had a pump installed or earthworks done to them, nothing.

MR CALDWELL: But if you take the view that they've been extracting nothing from an over-extracted system, therefore in a sense are being good citizens - I'm not suggesting that myself but one can see an argument being mounted.

PROF BUTTON: I've been in the invidious situation where I've been engaged by a very large corporate on the Barwon-Darling to investigate the entire Barwon-Darling River between Queensland and Victoria and give them a list of unused licences. On the one hand, yes, we can identify them - what is the best thing for me to advise that client to do? To advise the government to take them out of the game, so that the supply reliability of themselves as an active legitimate irrigator is not undermined, or advise them to go into the marketplace and buy those licences and transfer them at a discount reliability - those licences, instead of transferring a thousand megalitres, they give 30 per cent or 50 per cent back to the pond - what is the best option to advise them as an environmentally responsible citizen?

I would far rather see the game simplified and the rules regulated and some degree of clawback associated with government mismanagement at state government level just cancel them. If you have not used them, you lose them.

MR BRAITHWAITE: If you do that on the basis of whatever your allocation is now - you know, your 50 per cent or 60 per cent - aren't you actually reinforcing the environmental view? You're basically saying, "Well, the environment has got it right, they get that flow and that's it"?

PROF BUTTON: No. Basically, what you're saying is, "Okay, we're in a situation now where we know our 50 per cent reliability will not be eroded any further by those coming into action."

MR BRAITHWAITE: I understand the lack of certainty and reliability is your main concern.

MR CALDWELL: That's why the fixed charge is in here, that's one of the reasons - to drive those sleepers into the market.

MR BRAITHWAITE: I would have thought that would have been the case too, that those who slept on \$800 every five-year licence would - - -

PROF BUTTON: Start wanting to get some return from - - -

MR COSGROVE: As you were saying, Robert, they're also picking up each year this fixed charge.

MR CALDWELL: They are. That's invidious once you get down to the zero allocation situation. You don't like that if you're paying all these fees and getting no water, but then on the other hand, it's driving the sleepers out into the marketplace and activating more usage from them. Because of the Murray-Darling Basin cap, it's sitting there and they're saying, "We've put a ceiling on the actual usage." It's very complicated, isn't it?

MR COSGROVE: It is.

PROF BUTTON: You can't solve all these problems but, unless I'm mistaken, Commonwealth payments due to the state in return for the progress in implementing these Hilmer reforms are - quite clearly it is in the interests of state governments to be seen to be doing the right thing under the competition policy reforms, but it's the way in which they're doing it and it's the undermining of the security of rural and regional Australia which is not being heard.

I personally believe that the Commonwealth have an obligation to tie the transfer of those funds to states, not just on the basis of them having conformed to the implementation of policies, but demonstrated that they have consulted with local communities adequately and have evaluated the economic impact of those measures

on the local community. I think those payments to states should be made conditional on a demonstrated economic analysis of the results of the implementation of those policies.

MR COSGROVE: But in looking at the impacts on the community, I think they've got to look at the impact on more than the community - until the reforms took place - as being using that water at a certain price. There are, as you're agreeing, other people in different parts of irrigation valleys who would like to have more water to do other things.

PROF BUTTON: Yes. The economic impact can extend right down river. There could be a substantial economic impact from reserving to environment and generating tourist flow and all those sorts of things, but those analyses have never been done and I believe those economic analyses of reserving water to various uses should be done.

MR CALDWELL: Actually, if you have a look at that note at the back which says "two" on the top right-hand corner, right down the bottom of the page, the Liberal National Party got written into the Water Act that the social and economic impacts on affected communities must be taken into consideration. I think the DLWC have only given that lip service. They did gross margin work and now they've got a new economist on and they're thinking about doing a few pilot - what do you call it - a few case studies, and this is about three years after. That should have been done before they introduced the water and they haven't done it. That's why I'm a little cynical, if they're not even complying with their own laws.

MR BRAITHWAITE: Robert, could I just ask a question. In the terms of the reforms, have you actually practised or have you seen practised a different use of water to save water, stop the wastage? Have you seen that practice along the Lachlan?

MR CALDWELL: People save water by landforming. They reduce their waterlogging and degradation and it drains off and they put money back into the farm improving drainage works.

MR COSGROVE: Have the water reforms, would you say, had any impact in encouraging people to do that, make more options for them?

MR CALDWELL: The money that I used to spend doing that sort of work, I don't spend it any more, because I haven't got that spare money any more. It has gone in water charges. So I just don't spend it and I'm just struggling along. I suppose the big attitude is, well, when you get sick of struggling you will sell out and someone more efficient will take over, but it just depends whether you think the water rights that I've been given 35 years or 50 years ago to my farm, whether you consider they're really owned by the government and they're just going to sell the water or whether they're just assigned to me as a water right, and I don't mind paying them charges to

operate the dam and this sort of thing and so, you know, it's a philosophical argument there really.

They are virtually taking over water rights, I think, and saying, "Well, now we are going to change the rules. We are going to have all this free market stuff," and my income - I can't cope with water that's worth \$170 one year and nothing the next, and some years I will get zero on occasions and other years I will get 50 per cent. That's what I'm faced with. It's just jumping all over the place, and I don't think that water resources are just implementing all this stuff in a sort of disorganised fashion with little regard to the profitability or the viability of the industry out there. They don't know what's going to happen but they're forced to implement it, so they're doing it and where they're cheating a bit, as I said, is with the reliability. They don't want to mention that word, but I can see. Wait till we get a few average years and a little bit below average and there will be no allocation. Everyone will scream out, "Oh, there's no water. What has gone wrong?" I've explained it pretty well, I think, haven't I?

MR COSGROVE: Yes.

PROF BUTTON: The implication of your question about whether an increased price of water will drive people to adopt more efficient water use practices, in theory it looks good. In practice it's not the price of water that drives increased efficiency of the use of that water; it's the drive towards improved yield and improved control of the production cycle and early understanding of what your likely yield is to be so that you can get into the markets beforehand and maximise your commodity prices by forward selling. It's that, not the price of water, that drives improved technology in agriculture.

I will give you an example. 10 years ago something like 75 per cent of all irrigational water was used to grow grass; just grown on land. It wasn't even formed to grow grass, and we've seen a very rapid move away from that flood irrigation through to bay irrigation in the rice industry, contour irrigation in the cotton industry, thorough irrigation now through to buried T-tape, trickle irrigation systems, landforming by laser levelling at the cost of \$150 an acre, which is redone every five years to make sure you plane it with a fall of one in a thousand or one in two thousand with a centimetre accuracy, to precision steering systems in agriculture now in Australia, so you can steer a tractor to within one centimetre of where you want it to be so you know exactly where to put the chemical and the fertiliser, to give the control over the whole production cycle so that they know how to respond to this square metre; if it didn't produce highly last year how much more it needs.

It's those factors that drive the capacity to respond and manipulate those inputs to capture a maximum yield and a maximum commodity price in the marketplace. It goes back to this issue of it's not the price of water; it's the unreliability; it's the lack of knowledge of when it's going to be available. It's the one element in the input production cycle that is beyond the control of the land-holder, besides the climate. Soils, fertiliser, labour, machinery, locking into markets before you grow the crops, commodity trading - - -

MR COSGROVE: It may be beyond the control of government administrators as

well unless they were to engage in enormous construction of water storages.

PROF BUTTON: No, we're not suggesting that we should control the availability of water. Land-holders have been able to work with nature's variability in supply and run-off of water. It's when you put bureaucratic manipulation into water management, and even down to the stage of saying, "On this particular run-off event you can't have it," whereas your licence says you can. It's that kind of changing the goalposts which is the disruption. It's not the price of water.

MR COSGROVE: I thank you both. We will continue with our effort to try to understand the ramifications of this complex sector.

PROF BUTTON: Thank you very much.

MR COSGROVE: I conclude today's hearing and we will be resuming tomorrow at 9.30. Thank you.

AT 5.10 PM THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 21 JULY 1999

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