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Application of the Industry Levy to fund the AER and AEMC

Submission in response to Discussion Paper issued
by the Ministerial Council on Energy Standing
Committee of Officials

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Introduction

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.

The Council formed in 1993 and currently has 88 members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of our membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

As a representative of investors in energy infrastructure assets, AusCID is concerned with many of the issues that need to be addressed in the current energy market reform process. The Council considers that the strategic direction set by a national energy policy will have wide consequences for the development of the energy market, as well as the broader economy.

Notwithstanding the MCE communiqué of December 2003, it is AusCID's strong view that the establishment of the Australian Energy Regulator (AER) and Australian Energy Market Commission (AEMC) clearly are public goods and should be funded by appropriate payments from Commonwealth and State budgets if they cannot be provided from existing resources.

As was discussed at the consultation session in Melbourne (and we understand also in Sydney) it is difficult to be able to comment properly on the funding issue in the absence of

- An understanding of the nature and size of costs the AER and the AEMC and how these will develop over time, and
- The extent to which these will differ from the costs currently incurred by NECA, the ACCC and the range of state-based agencies and the extent to which these costs are funded from budgetary and other sources.

That said we understand that thinking on this issue is much less advanced than in relation to other discussion papers and that senior officials welcome general views on how this issue might be progressed. It is in this spirit that we offer the following comments but would urge that the information set out above be provided to participants in the

consultation as soon as possible and that a commitment be given to a second round of consultations being held on these issues once concrete options have been developed.

Regulation – a mixed good

There are clearly three sets of beneficiaries from an efficient market for energy services in Australia

- Those individuals and firms who participate in energy markets for profit
- The end consumers of energy be they households or industrial/commercial users
- The general community who benefit from general levels of economic activity being higher than would be the case if markets were less efficient and as a corollary governments whose revenues are generally correlated to levels of activity in the economy as a whole

If the first group were the sole beneficiaries from the market then it would be appropriate for them to bear the full costs of the regulatory system – this is what seems to be currently proposed, although it must be noted that the discussion paper does not contain any analysis as to distribution of benefits from regulation.

Given the existence of other beneficiaries it is efficient in an allocative sense that they too should accept some of the costs of regulation. It should also be noted that there is relatively little difference in this discussion between households and the general community and given the “essentiality” of energy consumption, it is a fair approximation to say that market regulation (in its broadest sense) is a public good; in particular, it is both non-rival and non-exclusory in consumption. Public finance theory would therefore suggest that regulation is best funded by some form of broad based non-distorting tax.

The discussion paper seems to acknowledge that there are a range of beneficiaries but proposes charging only profit-seeking service providers, regardless of the extent of benefits they receive from the regulatory framework. It proceeds to discuss funding structures solely on the basis of the allocation of costs in isolation from the distribution of benefits. Allocative efficiency and the normal principles of public finance require that both costs and benefits need to be considered for mixed goods and in developing options for further consultation and presentation to the MCE, we would urge senior officials to ensure this is done.

Current funding arrangements

The funding of current market institutions is a mixture of license fees, fees for service and direct budgetary funding. This at a broad level seems to us to represent a reasonable compromise between the private benefits obtained by market participants and the public benefits that accrue to households and the wider economy from having efficient energy markets.

We are therefore concerned that Senior Officials are approaching the issue of funding on the basis that all costs for the operations of the AER and the AEMC are to be recovered directly from service providers. We note that the discussion paper assumes this to be the case based on the following words contained in the Communiqué of December 11:

Funding from the AER and the AEMC will be through appropriate industry levies approved by the MCE.

AusCID believes that in the absence of a clear public statement to the contrary from the MCE, this can be interpreted to mean that the current approach of both budget funding and other fees is not ruled out.

AusCID has asked Ministers, and in particular the Commonwealth Minister (given the bulk of the budget funding flows to the ACCC), to ensure that the level of budgetary resources currently being provided for energy market regulation is maintained in real terms over the next five years unless the costs of regulatory activities fall below that level of funding.

It is AusCID's strong view that the establishment of the AER and AEMC clearly are public goods and should be funded by appropriate additional payments from Commonwealth and State budgets if they cannot be provided from existing resources. However, we would expect that the efficiencies that are anticipated would mean that the total call on industry and government resources should actually fall. AusCID strongly opposes any attempt for this important reform process to be used to replace current funding from general government sources with a new energy industry taxation regime.

In any event, whatever costs are to be recovered from market participants (for whatever reason) must form part of their operating cost base for regulatory purposes.

“Fees for service” and funding of litigation and appeals

Investors and operators are concerned that whatever funding arrangements are put in place that they should not constitute a “blank cheque” for regulators to pursue individual service providers in the way that service providers of gas pipelines in Western Australia have had to bear the costs of the WA Gas Regulator. There must be clear accountabilities and restraints placed on regulators in relation to the costs they incur in relation to regulatory approval processes (technical, economic and legal costs). Where service providers are successful in challenging mistakes of regulators, service provider’s costs must be reimbursed their costs and not be required to fund the regulator’s costs.

Regulators should be required to budget for their annual workflow in the same way as other government agencies do. Furthermore, given that it is intended that the AER and the AEMC are to be afforded wide ranging functions and powers, there must be a clear case made whenever the costs in carrying out each of these functions and powers are to be recouped on a “fees for service” basis.

AusCID strongly believes that the activities and budgets of both the AER and the AEMC should be subject to normal budgetary scrutiny. We would also encourage consideration of a process of public scrutiny of budgets similar to that used for FERC in the United States.

Future charging structures

Whatever is the final quantum of money required from the market to fund the AER and AEMC, it will be small in comparison to the markets’ total turnover. Therefore, the likelihood of any reasonable structure significantly affecting market conduct is relatively low.

The more complicated the structure is, the more likely it is to create unexpectedly perverse outcomes. Trying to allocate costs through the value chain will be relatively arbitrary and more likely to create distortions than a license or end user fee structure. The replacement of wholesale sales tax and other indirect taxes with the GST is analogous to this.

It seems to us that there are two basic tools for imposing charges on the market:

- *License fees for market participants.* Individual firms which receive a benefit from the regulatory structures to be implemented could pay a fee to participate in the market based on the nature of their activity and possibly their size. Such fees would be allowed as part of their operating cost base. In adopting

such an approach it would be necessary to review license fees currently imposed at a state level both from the view of ensuring there is no “double dipping” as functions are transferred from state to national bodies and also to try to harmonise, in both structure and magnitude, what state fees remain in the market.

- *A simple tax on end users.* The discussion paper notes in several places that in the final analysis any costs imposed on market participants will end up being met by end users. If this is the case, recovering the costs directly from them creates no issue in equity and has the advantage of being more transparent (end users will know what market regulation is actually costing them) and it essentially eliminates the risk of the recovery arrangements impacting on investment, entry or any other market conduct. Ideally, a rate per unit of consumption would be struck for electricity and another for gas.

Clearly, a combination of these could be used but this may overly complicate matters for little gain.

The strong message here is whatever regime is chosen, providing market conduct is not affected, simplicity and transparency should be the driving concerns. Given these objectives, AusCID would see direct recovery from end users as the preferred approach.

If Senior Officials wish to discuss these issues further, please contact Dr Warren Mundy on 0409 911554 or by email regulation@auscid.org.au.