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**The Changing Role of the State in New Zealand's  
Electricity Industry.**

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# The Changing Role of the State in New Zealand's Electricity Industry.

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## ABSTRACT

This paper presents an overview of the role of the state in New Zealand's electricity industry. The first part of the paper provides an overview of the states gradual process of gaining absolute control and then subsequently developing the industry. Part one ends with a more detailed look at the policies of the National government from 1975 till 1984. The purpose of this part is to present an overview of the development of the industry and to provide a context for future reforms. New Zealand's regulatory environment and the electricity industry were quite different to what they are today. Part two will look at New Zealand's experience of economic liberalisation and what this has meant for the electricity industry. This will consider how these policies were implemented and specifically what this meant for the structure of the industry. It will also consider events that would undermine the predictions that the free market would provide the best possible electricity supply for the New Zealand public. The third part will look at the approach of governments since 1999. This essay argues that this is marked change in general policy that is illustrated by events in the electricity industry. This paper argues that this change rejects the ideological approach of the previous 15 years and replaces it with pragmatic solutions to problems in the electricity industry. This change in direction has been heavily influenced by New Zealand's experience of liberalised industries.

**Approximately 15,000 Words.**

New Zealand in the late 1840's was England's newest colony. It was in dire need of investment and development in order to establish its economy. Despite the undeveloped nature of the country it quickly began using electricity. The first recorded use of electricity was for a private telegraph line that ran between Dunedin and Port Chalmers in 1862. The new technology was quickly placed under state control with the Electric Telegraph Act 1863 establishing central control over electric telegraphs under the Electric Telegraph Department.<sup>1</sup> Electricity as a power source took longer to develop.

<sup>1</sup> John S. Adams (ed) *People, Politics and Power Sources* (MNZ and the Historical Branch, Department of Internal Affairs, Wellington 1996) 12.

## **I. INTRODUCTION**

This essay traces the state's changing role in New Zealand's electricity industry. Electricity has been used in New Zealand since the late 1800's and the state has been heavily involved for almost this entire period. This essay will present the role of the state in three broad parts. The first part is from the late 1800's until 1984. This is the development of and then complete control of the industry by state. It will focus particularly on the Muldoon government from 1973 till 1984. The second part of this essay will focus on the period from 1984 till 1999. This was a period of massive reform for New Zealand. This essay will look at New Zealand's experience of economic liberalisation and what this has meant for the electricity industry. Particularly it will consider how the reforms were implemented despite widespread public resistance. The third part of the essay begins with 1999 and focuses on the recent decision to implement an Electricity Commission and this Commission's role in security of supply. This essay argues that this is a marked change in direction from previous reforms and attempts to explain what has influenced this change.

## **II THE DEVELOPMENT OF THE NEW ZEALAND ELECTRIC INDUSTRY.**

### **A Early Development of the Electricity Industry 1860-1918.**

New Zealand in the late 1800's was England's newest colony. It was in dire need of investment and development in order to establish its economy. Despite the undeveloped nature of the country it quickly began using electricity. The first recorded use of electricity was for a private telegraph line that ran between Dunedin and Port Chambers in 1862. The new technology was quickly placed under state control with the Electric Telegraph Act 1865 establishing central control over electric telegraphs under the Electric Telegraph Department.<sup>1</sup> Electricity as a power source took longer to develop.

<sup>1</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and the Historical Branch, Department of Internal Affairs, Wellington 1998) 15.

Early reports of electricity use began to appear in the late 1870's. This included a game of soccer played under floodlights at the Basin Reserve in 1879, the Union Steamship Company of New Zealand's ship the "SS Manapouri" use of electric lights in 1881, (either the first or second merchant boat in the world to have electric lights)<sup>2</sup> and the Bullendale mine having an electric generator in 1884.<sup>3</sup> As with telegraphs the government stepped in to take control of this new technology. The Electric Lines Act 1884 prohibited the erection of power lines for public supply without special legislation. While this Act was important in the governments control of the industry more effective control would come with the Municipal Corporations Act 1886. The Act gave local authorities the sole right to use waterpower to generate electricity and supply it's citizens with electric power. Private companies could only supply electricity publicly under a special Act of parliament.<sup>4</sup> This section would provide the means for most of the early development of the electricity supply. In 1888 Reefton became the first New Zealand city to have a public supply of electricity. English entrepreneur and electrician Walter Prince brought a small one Kilowatt demonstration unit which was used to light the Dawson hotel in 1886. By early 1888 Reefton had built itself a permanent power station that was used to light the whole town.<sup>5</sup>

In 1881 three private Acts were passed to allow the private development of an electricity supply in Auckland, Wellington and Christchurch. The Acts gave each of the city councils the right to purchase the privately built generating plant after ten years. In 1889 Wellington became the first major center to have an electricity supply.<sup>6</sup> Auckland would take a further 18 years to get a public electricity supply. Despite widespread control over the ability to generate electricity the national legislature had not yet begun any infrastructure development.

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<sup>2</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. (Bookprint Consultants Ltd, Wellington, 1989) 13.

<sup>3</sup> Peter M. Chamber and Ron C. Hall *Let There Be Light: A History of the Bullendale and the Generation of Electric Power in Central Otago*. (Central Otago News Ltd, Alexandra 1986) 23.

<sup>4</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. (Bookprint Consultants Ltd, Wellington, 1989) 34.

<sup>5</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and Historical Branch, Department of Internal Affairs, Wellington 1998) 15.

<sup>6</sup> Rennie, above, 36.

As the turn of the century approached the government began to realise the importance of electricity and that they were the only entity large enough to develop the new technology nationally. The government moved to take secure control over New Zealand's water resources. They passed a series of Acts<sup>7</sup> cumulating in the Water Power Act 1903 decisively vesting in the crown the right to use water for electricity generating purposes.<sup>8</sup> Importantly under this Act these powers could only be delegated to local authorities, not to private individuals.<sup>9</sup> It was these Acts that were to form the main basis for future intervention in the electricity industry. The Acts severely limited the role of private enterprise that had been central to the industries early development up till this point.

The Public Works Amendment Act of 1908 was the first formal statement that the government was to have a key role in the construction of generation capacity. Even at this time the government did not have the funds to develop this new resource. The Acts attempt to have strict controls over the new technology was watered down by the ability to issue private licenses to individuals to construct hydro schemes.<sup>10</sup> Even with this ability the early development was extremely slow and by 1910 the government had decided that it was their sole role to fully develop the industry.<sup>11</sup> The government passed the Aid to Water Power Act 1910 that gave them the power to borrow to fund hydro development. This led to the states first major construction of a power generator in New Zealand. The Coleridge Power Station began construction in 1911 and was opened in 1914 by then Prime Minister Bill Massey.<sup>12</sup> With this also came two 66kV transmission lines into Christchurch. These were completed in 1914 and at 100Km were the largest of their kind in New Zealand. From this point on the government became the main generator and supplier, developing a national grid to supply large consumers. The Power Boards

<sup>7</sup> See also the Public Works Act 1882, Mining Act 1886 and the Electric Motive Power Act 1896.

<sup>8</sup> Waitangi Tribunal *The Whanganui River Report : Wai 167* (Net Version, 1999) 325.

<sup>9</sup> Rennie, above, 34.

<sup>10</sup> Public Works Act 1908, s 5.

<sup>11</sup> Waitangi Tribunal *Te Ika Whenua Rivers Report : Wai 212* (Net Version, 1998) 43.

<sup>12</sup> The Institution of Professional Engineers New Zealand *Lake Coleridge Power Station* (Web-page) See <http://www.ipenz.org.nz/heritage/itemdetail.cfm?itemid=58> last accessed 15 September 2003.



Act 1918 established the Power Boards as the main retailers.<sup>13</sup> These elected boards were the sole suppliers of electricity, charging one standard price to rural and urban users. The mastermind behind the Power Boards, Alex Wyllie Rodger, ultimate aim was that rural woman should have the same electric benefits as their urban counter-parts.<sup>14</sup> This established electricity as a utility, it was something that was provided as a state service, not a commodity to be brought or sold. By 1919, there were 64 supply authorities, most of which were operated by borough councils.<sup>15</sup> These supply authorities all acted independently and even at this stage some districts were still without an electrical supply.<sup>16</sup>

The decision to implement total state control over the electricity industry was not unusual for the time. New Zealand largely followed the English legislature who had placed the electricity industry under government control citing safety concerns.<sup>17</sup> Even without this influence it was likely that the New Zealand state would have intervened. The Liberal government that held power from 1891-1912 was considered to be extremely interventionist.<sup>18</sup> Policies at this time were formed on an ad hoc basis as situations arose, more often than not by implementing state control.<sup>19</sup> The general regulation levels were so high that one description of New Zealand at the time was that it was practicing "socialism without doctrines."<sup>20</sup> Faced with a new industry that looked to be extremely important for New Zealand's future economic well-being it would be expected that the state would become heavily involved.

<sup>13</sup> Waitangi Tribunal *Te Ika Whenua Rivers Report : Wai 212* (Net Version, 1998) 43.

<sup>14</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. ( Bookprint Consultants Ltd, Wellington, 1989) 95.

<sup>15</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and the Historical Branch, Department of Internal Affairs, Wellington 1998) 71.

<sup>16</sup> N M Speer *The Electrical Supply Industry in New Zealand* (Electrical Supply Authorities Association of New Zealand, 1962) 61.

<sup>17</sup> Martin, above, 37.

<sup>18</sup> David Hamer *The New Zealand Liberals: The Years of Power 1891-1912* (Auckland University Press 1988)

<sup>19</sup> W.P. Reeves, *State Experiences in Australia and New Zealand*, I, Melbourne, 1969 (Facsimile reprint of 1923 edition) 73.

<sup>20</sup> Andre Metin, *Socialism Without Doctrine*, (Sydney, 1977) (Translation of *Le Socialisme Sans Doctrines*, 1901). Cf. Andre Siegfried, *Democracy in New Zealand*, (1982) reprint of 1914 edition.

## B. Development of a Mature System

The government's decision to invest in electricity infrastructure was put on hold during World War I as labour resources and government capital were diverted to the war effort. For example, while feasibility studies to build a hydro station on the Mangahoe River began in 1906 and a decision to build was made in 1915, construction did not start until 1920.<sup>21</sup> With World War I ending in 1919 the government continued to build plants to supply electricity across New Zealand. The use of electricity would grow by over 350% in the 1920's.<sup>22</sup> The government responded by investing in the construction of several large hydro stations on the Waikato River and in the South Island. Even at this time the government was the only entity in New Zealand with the capital to undertake the program.<sup>23</sup> This pattern with state as builder of generation plant and sole supplier of electricity continued with little disruption until the outbreak of the Second World War.

The outbreak of World War II created another stall in the development of the electricity industry. The war again led to labour and coal to be in short supply with a series of coal strikes emphasised the latter.<sup>24</sup> Demand soon outstripped supply and the Electricity Emergency Regulations were issued under the Emergency Regulations Act 1939. These regulations created the office of electricity controller who had wide powers over electricity including the power to allocate electricity to Power Boards.<sup>25</sup> This power was often used with power restrictions soon becoming a daily occurrence. The extent of the problem can be highlighted by a two-day relaxation of lighting restrictions introduced as a celebration of Victory in Europe. These celebrations were quickly followed by the

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<sup>21</sup> Todd Energy *Mangahao Power Station* (Website) see

<http://www.todd.co.nz/te/pages/main/corporate/mangahaohydro.htm> last accessed 25 September 2003.

<sup>22</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and the Historical Branch, Department of Internal Affairs, Wellington 1998) 123.

<sup>23</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. (Bookprint Consultants Ltd, Wellington, 1989) 68.

<sup>24</sup> Jennifer King *Sign of Service: A Jubilee History of the Auckland Power Board*. (Wilson and Horton Limited, Auckland 1972) 31.

<sup>25</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and the Historical Branch, Department of Internal Affairs, Wellington 1998) 128.

Electricity Controller calling for general economy and rotating power cuts.<sup>26</sup> The restrictions did not end with the war. Power cuts still occurred up till 1947 and further restrictions remained for another five years after this.<sup>27</sup> These restrictions were taken seriously and included inspectors who had the power to enter homes "at reasonable times" and disconnect appliances being used in breach of the restrictions. On the 1 April 1953 the government lifted the restrictions and consumers could use as much electricity as they pleased. In the same year the Power Boards announced their first modest price increase ever. For 33 years the Power Boards had absorbed all price increases in bulk electricity prices.<sup>28</sup>

The new found freedom of unlimited electricity was short lived. By 1955 there were new shortages and the government cut supply to authorities by 11%.<sup>29</sup> The stall in investment during World War II had meant that growth in electricity demand had not been matched by a growth in supply. New Zealand simply lacked the base capacity to supply its population. This led to the North Island Power Supply Committee being set-up to forecast power supply and demand trends for the next decade. Much to the relief of the industry the government followed the committee's recommendations and embarked on a 7-year plan that included a Waikato coal plant and a Wellington Gas plant. This plan took time to have an effect, while 1957 was described as a year "virtually without restrictions" this was followed by a year that required the most severe restrictions without power cuts ever.<sup>30</sup> It would take until 1962 before generation would catch up with demand.<sup>31</sup>

From this point on the electricity industry fell into a familiar pattern. The government was practically the sole generator. It sold power to supply authorities that

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<sup>26</sup> N M Speer *The Electrical Supply Industry in New Zealand* (Electrical Supply Authorities Association of New Zealand, 1962) 35.

<sup>27</sup> Speer, above, 41.

<sup>28</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. (Bookprint Consultants Ltd, Wellington, 1989) 197.

<sup>29</sup> Speer, above, 45.

<sup>30</sup> Jennifer King *Sign of Service: A Jubilee History of the Auckland Power Board*. (Wilson and Horton Limited, Auckland New Zealand 1972) 50.

<sup>31</sup> Rennie, above, 166.

then sold it to customers. A few very large users received direct supply from the government. The supply authorities were statutory monopolies over a geographical area in which they had the sole right and obligation to supply electricity. This was still a period of large-scale development. Power Boards in particular found themselves undertaking large development projects in order to meet supply.<sup>32</sup>

While the supply of electricity stabilised in the 1960's electricity remained a public focus. In the 1960's the government made an agreement with Camalco to build an aluminum smelter at Taiwai point and power stations at Manapouri and Te Anua. The government took over the obligation to build the power stations in 1963. The original plans involved raising the lake levels of Te Anua and Manapouri by up to 30 Meter's. As construction progressed it quickly became apparent that this would spell ecological disaster for the area around the lakes.<sup>33</sup> By 1969 the effect of raising lake level was hitting national headlines and by 1970 the "Save Manapouri" campaign had attracted 264, 907 signatures. This was close to 10% of the population at the time. In 1972 Norman Kirk was elected with a platform that included a strong endorsement of the "Save Manapouri" ideals. The government confirmed that lake levels would not increase as much as first proposed and created the Guardians of Lake Manapouri, Monowai and Te Anua. This was a group a six independent individuals whose brief was to oversee the management of lake levels. Protection of the lakes was eventually passed into law. The Manapouri-Te Anua Development Amendment Act was passed in 1981 setting guidelines for lake levels.<sup>34</sup> This campaign is considered the beginning on New Zealand's environmental consciousness and activism. For the electricity industry this was to trigger the beginning of systems to protect the environment that would take a much wider view of the impact of major engineering works.

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<sup>32</sup> Rennie, above, 167.

<sup>33</sup> A.F Mark *Integrating Conservation With Hydro- Electric Development of Lakes Manapouri and Ta Anau, New Zealand: an Exercise in Complexity*. (Botany Department, University of Otago) 4.

<sup>34</sup> John E Martin (ed) *People Politics and Power Stations* (ECNZ and the Historical Branch, Department of Internal Affairs, Wellington 1998) 217.

### C. *The Muldoon Years.*

National was elected after the incumbent Labour party lasted only one term. The Labour government was unable to survive two major economic crises' that changed New Zealand's economy forever. First, England joined the European Economic Community (EEC). With this move New Zealand lost its assured market for meat, wool and dairy products. This was an arrangement that had funded New Zealand's economy for much of the 20<sup>th</sup> century. To make matters worse England also joined the EEC's Common Agriculture Program. This provided subsidies for farmers and artificially high guaranteed prices. New Zealand had not only lost its assured market but was now trying to compete with subsidised European meat. In the 15 years after 1973 Britain changed from a net importer of meat and dairy products to a net exporter.<sup>35</sup> The traditional basis of New Zealand's economy had just been severely undermined. The second crisis came with the 1973 oil shock. The Organisation of Petroleum Exporting Countries began to limit the supply of oil to world markets. Between January 1973 and January 1974 the price of a barrel of oil went from \$US2.59 to \$US11.65. This price hike came when oil was our biggest single import. The oil shock had a profound effect globally and led to a crash in buoyant commodity prices. New Zealanders found its main export had lost its primary market, their income had halved and the price of our main import had quadrupled.<sup>36</sup> New Zealanders were faced with the prospect that their standard of living may be dropping for the first time in history. There is a general consensus among commentators that 1974 marked a significant turning point in New Zealand's economic history. The post war boom period that lasted from 1945-73 and brought full employment, high profitability and low inflation gave way to economic stagnation, high inflation, balance of payment deficits and the highest unemployment rate since the great depression.<sup>37</sup> Muldoon came back to office realising the problems New Zealand was facing, stating after the election "the time has come for New Zealanders to take a deliberate cut in our standard of living

<sup>35</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand.* (Bookprint Consultants Ltd, Wellington, 1989) 197.

<sup>36</sup> Rennie, above, 197

<sup>37</sup> Jon Johansen, *Political Leadership in New Zealand.* (VUW 2002) 172.

in the interest of future solvency.”<sup>38</sup> Despite this statement there would be little done to restructure the economy in the next 9 years.<sup>39</sup>

Muldoon's term was characterised by extremely high levels of government intervention. The economy was protected by large tariffs and subsidies, when inflation started to rise it was combated by a price freeze and then subsequently a wage freeze.<sup>40</sup> State departments were huge organisations that ran anything from social welfare to forestry. The departments were often used to implement ad hoc political policies and were usually grossly inefficient at providing their core function. Richard Prebble later stated that when he first became minister of State Owned Enterprises (SOE's) every one of these departments ran at a loss, collectively they only produced only 10 percent of the country's output despite having 20 percent of the investment.<sup>41</sup> Electricity was the epitome of this model. Electrocorp (ECNZ) controlled generation and transmission and was supervised by the Department of Energy, Electricity Division (NZED). This Department was formed in 1978 from the formerly independent Department of Electricity and Mines and the small policy body, the Ministry of Energy Resources.<sup>42</sup> The department was used for a variety of often-contradictory policy goals. Investment decisions were often made for political reasons rather than for electricity needs. ECNZ controlled 97% of generation and set the price of bulk electricity.<sup>43</sup> Its monopoly was entrenched by the Electricity Act 1968, which provided that all other hydro generators must hold a government issued license except ECNZ.<sup>44</sup> Retail was by Electricity Supply Authorities (ESA). Usually these were either Municipal Electricity Departments in urban areas or Electric Power Boards in rural areas. The Municipal Energy Departments were

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<sup>38</sup> Paul Dalziel and Ralph Lattimore. *The New Zealand Macroeconomy: A Briefing on the Reforms*. (Oxford University Press, Auckland, 1999) 16.

<sup>39</sup> Johansen, above, 176

<sup>40</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland, 1997) 7.

<sup>41</sup> Richard Prebble *I've Been Thinking* (Seaveiw Publishing, Wellington, 1996) 7 and 23.

<sup>42</sup> Allan Bollard, Robert Buckle *Economic Liberalisation in New Zealand* (Allen & Unwin Ltd, New Zealand, 1987) 154.

<sup>43</sup> Geraldine Baumann, Bryant Gunderson and Quentin Hay "The Contractual Matrix in a Deregulated Electricity Industry" *Conference of the Electric Power Supply Industry* (Volume 2, Christchurch, 19-23 September 1994) 122.

<sup>44</sup> Electricity Act 1968, s20.

run through the trading arms of local governments under the ambit of the Local Government Act 1974. The Power Boards were mainly rural based and run under the Power Boards Act 1925. The ESA's were required to buy electricity from ECNZ unless there was a specific government exemption.<sup>45</sup> These boards did not operate for profit and generally saw their role as having a large social service aspect. Generally this led to commercial users subsidising domestic users.<sup>46</sup> For example, in the year ended March 1984, domestic prices were 4.70 cents per kWh, while the commercial price was 7.54 cents per kWh.<sup>47</sup>

National's approach to the economy was a combination of Keynesian economics and ad hoc state intervention. Keynesian economics was used to justify government borrowing to help balance the economy. The basis of this view was that an increase in government spending would kick-start the economy and lead to growth.<sup>48</sup> When the second oil shocks hit in 1979 these policies led directly to the "Think Big" projects as a mechanism for recovery.<sup>49</sup> The term "Think Big" was a term originally applied to a group of large energy based investments.<sup>50</sup> These projects had a dual role, the first was to decrease New Zealand's dependence on foreign fuel sources. The second role was to revitalise New Zealand's floundering economy. The government would promote (and usually protect) big, capital intensive industries that would then drag the rest of the economy into a process of sustained self-generating growth.<sup>51</sup> In the energy sector this led to the building of the Synfuel plant and the Clyde Dam.<sup>52</sup> The former of these required the government to pay for it to be taken off its hand's; the later ran hugely over its construction budget and required legislation to overturn an environment court ruling in

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<sup>45</sup> Electricity Act 1968, s 26.

<sup>46</sup> Russel McGeorge "An Overview of the Reform of the Electricity Industry" *Conference of the Electric Power Supply Industry* (Volume 1, Christchurch, 19-23 September 1994) 174.

<sup>47</sup> *Energy Data File January 1999*, Ministry of Commerce, p. 118.

<sup>48</sup> Roger Douglas *Unfinished Business* Random House New Zealand, Auckland, 1993) 21.

<sup>49</sup> Neil Rennie *Power to the People, 100 years of Public Electricity Supply in New Zealand*. (Bookprint Consultants Ltd, Wellington, 1989) 197.

<sup>50</sup> Subsequently the term would be used to describe virtually any large-scale investment drive mooted for the early eighties

<sup>51</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland 1997) 18.

<sup>52</sup> Peter Kammiller "Think Big Mark Two, The Electricity Version" (10 February 1995) *The Independent* Auckland, 7.

order to proceed.<sup>53</sup> The projects were almost without exception considered a failure. These failures would subsequently be blamed on the Muldoon government's mismanagement. This was not without justification, however the failure of the projects was actually caused by a mix of reasons some foreseeable, some not. For example one problem was that the New Zealand construction industry was too small to attempt to build these projects all at once, a situation that was clearly foreseeable.<sup>54</sup> Another example points out that the projection for the Synfuel plant to be profitable required the price for a drum of oil to be around \$25, this was below the expected price oil would fall back to after the oil shocks.<sup>55</sup> When prices unexpectedly fell to below \$20 the Synfuel plant was a failure. This does not mean the decision to build the plant in the first place was not prudent.<sup>56</sup> In future years reasons that were not foreseeable tended to be overlooked and the projects were used as an example of government's inability to make investment decisions. The energy sector provided other losses around this time. A joint venture between the government and the private sector led to the Maui gas field coming on line in 1979. As part of the deal the government undertook to buy a significant amount of the gas annually. The government had planned to use this gas to fuel a series of thermal plants in the upper North Island. Unfortunately electricity demand was overestimated and two of the expected power plants were not built. The government was left with a having to pay substantial amounts for gas it had not used.<sup>57</sup> This was added to the list of energy failures from around this period. The projects massive expense meant that the positives from this era are often overlooked. Both the Maui deal and the Clyde Dam were expensive, however it should be noted that Maui has provided gas at artificially low prices since 1979 and that the Clyde Dam still operates as a major generation asset.<sup>58</sup>

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<sup>53</sup> Clutha Development (Clyde Dam) Empowering Act 1982

<sup>54</sup> Brain Easton, above, 19.

<sup>55</sup> Jon Johansen, *Political Leadership in New Zealand*. (VUW 2002) 19.

<sup>56</sup> Brain Easton, above, 19.

<sup>57</sup> James Willis *The Maui Gas Contract, a Brief History*. (Bell Gully Publications, 1998) see [http://www.bellgully.com/publications/ener\\_1998\\_03\\_maui\\_gas.html](http://www.bellgully.com/publications/ener_1998_03_maui_gas.html) last accessed 25 September 2003.

<sup>58</sup> Dennis Welch "Power Without Responsibility" (April 19-25 2003) *The Listener*, 18.



The "Think Big" failures added to criticism about Muldoon's economic approach.<sup>59</sup> A 1981 Treasury report warned the Prime Minister that his existing framework would simply not work.<sup>60</sup> The prime minister rejected this outright. Muldoon increasingly found himself with few supporters of his economic style, whilst he was still dealing in the monetary policy of Keynes his officials were increasingly advocating neoclassical ideas along the lines of Adam Smith's invisible hand.<sup>61</sup> The failure of the "Think Big" projects would add to the validity of these views in the next few years.<sup>62</sup>

The Muldoon era ended in a snap election in 1984. There had been speculation of this for some time and the event was eventually triggered by a report that National MP Marilyn Waring was ready to resign from the National party and declare herself an independent if the government tried to force her to oppose Richard Prebble's no nuclear bill.<sup>63</sup> The National government suffered its worst result since the inception gaining only 35.9% of the vote. Despite this result Muldoon refused to step down. In the two-week period before the writs were returned the Labour government requested that Muldoon devalue New Zealand's dollar. Initially he refused and only stepped down when it appeared the Governor General would step in. His refusal to devalue the dollar led to a massive run on the foreign currency with the reserve bank virtually exhausting its foreign reserves.<sup>64</sup> National had not attempted any of the reforms that they had indicated were required. New Zealand's economy was growing poorly and faced a public debt of around \$21.9 billion or 64.7% of the national GDP.<sup>65</sup> The electricity industry ended this era as one of the country's huge state departments. It was almost seen as a leech on the state and part of the problem that caused almost \$22 Billion dollars in public debt. Like the rest of the economy the electric industry was soon to face massive reform.

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<sup>59</sup> Ewen McCann *The influence of American Economics on New Zealand Thinking and Policy. (The Fullbright Seminars)* (Platform Publishing 1989 Wellington) 119.

<sup>60</sup> Treasury *Economic Strategy: An Overview* (GP Print, Wellington, 1981)

<sup>61</sup> Richard Prebble *I've Been Thinking* (Seaveiw Publishing, Wellington, 1996) 21.

<sup>62</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland 1997) 20.

<sup>63</sup> Roger Douglas *Toward Prosperity*. (David Bateman Ltd. Auckland, 1987) 39.

<sup>64</sup> Roger Douglas, above, 51.

<sup>65</sup> Paul Heath Q.C. "Consumer Bankruptcies, A New Zealand Perspective" (1999) See <http://www.yorku.ca/ohlj/PDFs/37.1.2/heath.pdf> Last Accessed 28 May 2003

### III THE LIBERALISATION PROGRAM

This part of the essay traces the period from 1984 through to 1999. It presents the basics of New Zealand's liberalisation program and what this meant for the electricity industry. It presents the view that over this period there was an overriding aim of a few key Ministers, business leaders and Treasury to move the electric industry from a government owned and protected industry into a competitive, privately owned free market.

#### A Labour's Liberalisation Program.

The Labour party returned to power in 1984 knowing the economy was in desperate need of reform. The Labour reform process proceeded rapidly and initially faced little opposition, as political actors distanced themselves from Muldoon's policies they had little choice but to accept the free market reforms. The electricity industry was at the centre of this. Its current structure was the antithesis of free market efficiency, its industries bloated and statutorily protected. It was an industry that was prime for the introduction of free market reform.

When the fourth Labour government announced its cabinet Roger Douglas was made Minister of Finance with David Caygill and Richard Prebble as associate Ministers. Treasury had, for the first time in almost a decade, found an ally in the Minister of Finance position. Treasury predicated this; the 1984 briefing to the incoming government *Economic Management* set out the blueprint for the reform process.<sup>66</sup> These three ministers and Treasury would provide the initial power base of the liberalisation program. This program was based on the neoclassical Laissez Faire economics that had increasingly found favour towards the end of Muldoon's term as prime minister.<sup>67</sup> The document outlined the poor performance of state run businesses and blamed this on an

<sup>66</sup> Treasury *Economic Management* (Wellington 1984)

<sup>67</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland 1997) 20.

absence of clear objectives, a lack of adequate performance monitoring and distortions in their operating market.<sup>68</sup> The document proposed efficiency through the market.<sup>69</sup> The drive behind the reforms was that forces of enterprise, self-interest and competition would generate efficiency and subsequently economic growth.<sup>70</sup> Wherever possible government organisations should be run like a business. For electricity this would be the beginning of a fundamental policy shift towards treating electricity like a commodity and increasingly exposing the industry to market forces.<sup>71</sup>

Initially the liberalisation process went unchallenged inside the Labour party, this is unusual for a party that has traditionally been more interventionist than others. The initial lack of internal conflict over the reforms was likely to have been caused by a combination of the "Think Big" failures, the failure of Muldoon's economic policies generally and a lack of understanding about the implications of the reforms. The Labour government had used the failure of "Think Big" and Muldoon's policies to get back into power. Once there the government had to be careful that it was not seen to be advocating policies that looked to be continuing Muldoon's approach.<sup>72</sup> The suggested policies of less state intervention with an underling philosophy of market efficiency were the opposite of Muldoon's ad hoc state interventionism. The Economic Statement of 1995 set out the principles for corporatisation of state departments. Non-commercial functions would be shifted to other state agencies, they would be given strict commercial goals, there would be no advantage given to these state businesses over any other and they would run under commercial directors from the private sector.<sup>73</sup> This policy was implemented with the State Owned Enterprise Act 1986. Wherever possible the State Departments were turned into State Owned Enterprise's (SOE's). The Act required that the principle objective of any SOE was to run as a successful business, all social policy

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<sup>68</sup> Alan Bollard and Robert Buckle *Economic Liberalisation in New Zealand*. (1987 Allen Unwin New Zealand Ltd, Wellington) 151.

<sup>69</sup> Treasury *Economic Management* (Wellington 1984) 285.

<sup>70</sup> A Bollard and M Pickford "Utility Regulation in New Zealand" in M E Beesley (ed) *Regulating Utilities: Broadening the Debate* (Institute of Economic Affairs and London Business School, London, 1997), 79.

<sup>71</sup> Barry Barton "More Restructuring: the Governments New Proposals for Electricity Reform," (1998) 2 *BRMB*, 134.

<sup>72</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland 1997) 23.

<sup>73</sup> Easton, above, 178.

objectives were removed.<sup>74</sup> Shareholding's in SOE's were split between the Minister of Finance and the relevant Minister. While these Minister's were still meant to be responsible to the house, their role in the day-to-day operation of the business was severely diminished.<sup>75</sup> The minister's job was effectively limited to appointing the board, approving annual statements and giving directions on dividends.

### **B The Initial Effect of the Reforms.**

In the electricity industry the SOE Act led to all of NZED assets being transferred to Electrocorp NZ (ECNZ) in 1987. The government was serious about Electrocorp being run as a business. Prominent businessmen and Business Roundtable members John Fernyhough and Rod Deane were appointed as board chair and CEO respectively.<sup>76</sup> These two were not only shrewd businessmen but were also strong proponents of privatisation.<sup>77</sup> In 1988 Transpower was set up as a subsidiary of Electrocorp to run the transmission services. While this shifted generation into a corporate structure, retail remained with the Power Boards at this point. The government had not overlooked the Power Boards. A task force was implemented in 1988 to look at the Power Board's structure and potential options for reform.<sup>78</sup> The task force reported a number of concerns about the industry. These were the same concerns that underlined the liberalisation process. Retailers were operating under unclear and sometimes contradicting goals, without adequate performance monitoring and received special operating conditions that protected inefficient behavior.<sup>79</sup> The answer that the task force recommended was deregulation of the retail market. The government should transform the ESA's into retail companies and remove their statutory protection. The fact that this would remove a large amount of regulation from the natural monopoly lines business did not appear to be a concern. Any abuses in the market could be dealt with through light-handed regulation and the Commerce Act 1986. The use of light-handed regulation

<sup>74</sup> SOE Act 1986, s 4.

<sup>75</sup> SOE Act 1986, s 6.

<sup>76</sup> Patrick Smellie "Hands Off Approach to SOE Policy Has Proved its Worth" (4 February 1994) *The Independent* Auckland, 10.

<sup>77</sup> "Chasing the Techies Holy Grail" (5 February 1999) *The National Business Review* Auckland

<sup>78</sup> Electricity Task Force 1988.

<sup>79</sup> Electricity Task Force, above, 7.

would become the primary method of government regulation for the industries monopoly assets.<sup>80</sup> The reports recommendations took until 1990 to have an effect under the Electric Power Boards Amendment Act. This allowed the government to appoint new board members to the Power Boards who would later become the directors of the retail companies when these companies were formed.<sup>81</sup> The fact that the government could not immediately corporatise retail was illustrative some of the huge barriers the liberalisation program faced in the electricity industry. Retail was a large industry in New Zealand; by this stage there were 53 Electric Supply Authorities with 9000 staff and an annual turnover of approximately 1.81 Billion dollars.<sup>82</sup> In order to reform this industry correctly there would have to be a series of steps over a sustained period of time to create a free market retail sector.

### **C The Policy Process.**

While the fourth Labour government had not yet privatised any state assets in electricity there had been other national asset sales. The first asset sales were in early 1987 with the sale of shares in the BNZ and Petrocorp. By 1990 the program had successfully sold New Zealand Steel, Petrocorp, Health Computing Service, Development Finance Corporation, Postbank, the Shipping Corporation, Air New Zealand, Landcorp mortgages, the Rural Bank, the Government Printing Office, the National Film Unit, Communicate New Zealand, State Insurance Office, Tourist Hotel Corporation, New Zealand Liquid Fuels Investment, Maui Gas Fields, Synfuels plants, forestry cutting rights and the Export Guarantee Corporation.<sup>83</sup> It was quickly becoming apparent that corporatisation often lead to privatisation. This did not seem to be the generally accepted policy in the Labour party. The Labour government had been elected without a coherent economic policy, vast differences between party members were

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<sup>80</sup> Light-handed regulation had three central elements. These are extensive information disclosure in order to increase transparency, the use of the provisions of the Commerce Act 1986 to deal with anti-competitive behaviour and the threat of further regulation such as price control if market dominance is abused. See Ministry of Commerce, Energy and Resource Division, Energy Policy Group, *Light handed Regulation of New's Zealand's Electricity and Gas Industries* (Ministry of Commerce, Wellington, October 1995)

<sup>81</sup> Kelsey, above, 52.

<sup>82</sup> Electricity Supply Association "Annual Report" 1989, 2.

<sup>83</sup> Jane Kelsey *Rolling Back the State* (Bridget Williams Books Ltd, GP Print, Wellington) 45.

papered over for the election. Its 1984 election manifesto was not published until after the election.<sup>84</sup> It is unlikely that these differences would have been resolved in favour of a wide-ranging privatisation program. Economist Brian Eastern supports this position:

“During 1986 at least three senior ministers stated that the intention was to improve the delivery of social spending and there was no intention to privatise SOE’s. Politicians rarely lie blatantly (although they are well known for being economical with the truth).”<sup>85</sup>

This view seems consistent with future events. Original asset sales were justified on the grounds of paying back massive public debt.<sup>86</sup> Clearly this was a pressing need for New Zealand and was accepted as an extreme measure to deal with an extreme circumstance. However as debt was repaid the asset sale continued. Jane Kelsey argues in her book *The New Zealand Experiment* that the privatisation of national assets was a policy implemented by a few key Ministers with the support of Treasury without mandate and in a deliberate way as to subvert opposition either internally or externally.<sup>87</sup> This statement seems to have a large element of truth to it. While Labour lacked a coherent economic policy, Treasury had clear goals. Its 1984 briefing to the government introduced corporatisation, its 1987 briefing was based on the necessity of privatisation of state assets.<sup>88</sup> Kelsey’s argument is that due to New Zealand’s lack of constitutional checks and balances the Finance team, with the support of Treasury, could capture New Zealand’s democratic institutions and implement this policy without a majority of support in the house. The process developed like this. The Finance team had the complete support of Treasury. They could almost always go to Cabinet and find a majority through core supporters. Due to the support of Treasury Ministers who disagreed often found themselves with no alternative well-formed policy to advocate. Once a majority was found in Cabinet then a majority could almost always be found in Caucus through the convention of solidarity. Under New Zealand’s First Past the Post electoral system a

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<sup>84</sup> Simon Walker *Rogernomics, Reshaping New Zealand’s Economy* (GP Books, Auckland, 1989) 211.

<sup>85</sup> Brian Eastern *The Commercialisation of New Zealand* (Auckland University Press, Auckland, 1997) 23.

<sup>86</sup> Bruce Jesson *Only Their Purpose is Mad* (Dunmoore Press Ltd, Palmerston North, 1999) 161.

<sup>87</sup> Jane Kelsey *The New Zealand Experiment* (Auckland University Press, Bridget Williams Books 1995)

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<sup>88</sup> Treasury *Government Management: Brief to the Incoming Government 1987* (Wellington 1987)

majority in Caucus would lead to a majority in the house. As a single house system with a single party ruling government and no entrenched constitution the elected party had complete power to pass legislation. Once control of the house had been obtained the next step was to implement policy quickly, avoiding public debate as much as possible. The use of the urgency provisions would prove to very effective, both in their ability to implement legislation quickly and in avoiding the select committee process. This approach to liberalisation has subsequently been coined as the "Blitzkrieg."<sup>89</sup> Roger Douglas in his 1993 book *Towards Prosperity* commented on the underlying philosophy to this approach:

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- If a solution makes sense in the medium term, go for it without qualification or hesitation. Nothing else delivers a result which will truly satisfy the public.
  - Consensus among interest groups on quality decisions rarely, if ever, arises before they are made and implemented. It develops, after they are taken, as decisions deliver satisfactory results to the public.
  - Do not try to advance one step at a time. Define your objectives clearly and move towards them in quantum leaps.
  - Vested interests continuously underestimate their own ability to adjust successfully in an environment where the government is rapidly removing privilege across a wide front.
  - It is uncertainty, not speed, that endangers the success of structural reform programs. Speed is an essential ingredient in keeping uncertainty down to the lowest possible level.
  - Once the program begins to be implemented, don't stop until you have completed it. The fire of opponents is much less accurate if they have to shoot at a rapidly moving target.
  - The abolition of privilege is the essence of structural reform.”<sup>90</sup>

Under this process the liberalisation program was pushed through the house with the view that it would be accepted when its results became apparent. This approach assumes that those implementing the reforms were correct in direction, approach and implementation and this would subsequently prove itself. The process had initially

<sup>89</sup> Brian Easton *The Commercialisation of New Zealand* (Auckland University Press, Auckland 1997) 73.

<sup>90</sup> Roger Douglas *Towards Prosperity* (David Bateman, Auckland, 1993) 215-238.

proved to be very successful, however by 1988 Roger Douglas's view was that left wing of the Labour party had began to reassert itself.<sup>91</sup> It was in this year that Douglas supporter Richard Prebble was dismissed from cabinet and Douglas himself was forced to resign.<sup>92</sup> He was subsequently re-elected to cabinet but not as Minister of Finance. Telecom was still privatised in 1990 but could only get through the house with its "Kiwi Share" proposal.<sup>93</sup> This required a certain amount of shares to go to New Zealand citizens and required that residential line charges did not increase faster than the rate of inflation. This was quite a departure from the usual process that was an unconditional sale by tender. The influence of the left became apparent in other areas. When NZ Post was made an SOE the Deed of Understanding required that the SOE cross-subsidised the loss making rural mail. Clearly central parts of liberalisation program were getting changed to placate dissident MP's. Perhaps the biggest sign of the conflicting pressure's in the government was when Jim Anderton resigned in protest at the privatisation of the Bank of New Zealand and Postbank.<sup>94</sup> The Labour party had effectively split in two with those supporting continued liberalisation on one side and those resisting on the other.<sup>95</sup> While this resistance could not reverse the liberalisation process it did manage to effectively stall it.

By the time the reforms slowed in 1990 they had achieved a large amount of structural change in the economy. For the electricity this change had been slower than for other industries. Electricity presented some unique problems for the liberalisation process. Electricity is characterised by high levels of technical complexity, the need for co-ordination of continuous delivery and the need for co-ordination of transmission security and investment.<sup>96</sup> If the aim was for privatisation then generation needed to be split from transmission, then generation would need to be further split to prevent a natural monopoly, competitive lines companies would need to be formed, the Power Boards

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<sup>91</sup> Brian Easton, above, 187.

<sup>92</sup> Simon Walker *Rogernomics, Reshaping New Zealand's Economy* (GP Books, Auckland, 1989), 209

<sup>93</sup> Kelsey, above, 45

<sup>94</sup> Chris Trotter "David Lange, Thanks for the Rise – or was that the Slide?" (3 March 1995) *The Independent*, Auckland 7.

<sup>95</sup> Simon Walker *Rogernomics, Reshaping New Zealand's Economy* (GP Books, Auckland, 1989) 219.

<sup>96</sup> Lewis Evans and Neil Quigley "Competitive and Centrally Planned decision Making in the Electric Industry." (2003) New Zealand Institute for the Study of Competition and Regulation.



needed to be changed to competitive businesses and then needed to operate in a competitive retail environment. All this had to be achieved without disrupting the supply of electricity to New Zealand. Labour had taken the first steps in this process. generation and transmission were in business structures and Power Boards had taken the first step towards retail competition. Governmental control over the industry was greatly diminished; almost all Ministerial oversight and influence had disappeared. By 1990 the Ministry of Electricity had been disbanded, the very limited role that remained was shifted to the Ministry of Commerce.<sup>97</sup> The directors of SOE's made decisions on all aspects of the business including infrastructure investment. The Minister's role had changed from directing on New Zealand's energy requirements and employment needs to appointing directors. The problem for the liberalisation program was that the time it was taking to reform the electric industry meant that it faced the mounting resistance against the liberalisation program.

Labour's inability to continue reforms was not matched by a reversal of high-level support for the liberalisation program. The government established a review of the structure and regulatory environment for the bulk electricity supply industry in 1988. The task force, including representatives from Treasury, the Ministry of Energy, the Ministry of Commerce and ECNZ, suggested large-scale deregulation and privatisation of the industry.<sup>98</sup> Transpower should be a separate entity subject to light-handed regulation.<sup>99</sup> Generation should not be subject to large scale break-up but should be split into two companies and subsequently privatised.<sup>100</sup> The Power Boards should be formed into companies and have their statutory monopolies removed.<sup>101</sup> As Labour's program stalled they were replaced by National who would continue the process Labour had begun.

<sup>97</sup> See [http://www.med.govt.nz/ers/electric/chronology/chronology.html#P44\\_4623](http://www.med.govt.nz/ers/electric/chronology/chronology.html#P44_4623) last accessed 25 September 2003.

<sup>98</sup> Electricity Task Force. *Structure Regulation and Ownership of the Electricity Industry. Report of the Electricity Task Force* (Wellington 1989) 9.

<sup>99</sup> Electricity Task Force, above, 15.

<sup>100</sup> Electricity Task Force, above, 20.

<sup>101</sup> Electricity Task Force, above, 7.

### **D National's Liberalisation Program.**

The liberalisation program was expected to be easier for National. Philosophically National was a party based on the economic freedom of the individual. Despite this the program hit some major barriers. National faced both internal and external pressure against the reforms. For electricity one of the major barriers were problems that began to arise in newly deregulated markets. Roger Douglas's view that consensus would emerge from interest groups "as satisfactory results emerge" was undermined by regular shortages and scandals in the industry. Despite this continued resistance National made large-scale structural change during the period up to 1999. For electricity often this was a process of finishing off the reforms that Labour had started.

National's main internal pressure came in the form of cabinet minister Winston Peters. Peters had campaigned on the policy of government re-intervention in the economy and ending asset sales. After the election he continued to be outspoken from cabinet. He was not alone in his criticism and often core policies were deviated to placate MP's wishes.<sup>102</sup> Whilst these factors made the process difficult the National cabinet was still controlled by free market fundamentalists. The internal pressure caused the liberalisation reforms to be slightly altered in the way they were implemented but there was no change in fundamental direction. National's resistance was not only internal; the reforms had begun to attract significant public resistance. The liberalisation process had turned to the labour markets and social welfare.<sup>103</sup> These areas tended to unite opposition, market liberalisation looked to be taking advantage members of society who could not protect themselves. Privatisation of national assets remained unpopular. Whilst Labour's assets sales had been extensive they had avoided core assets. National, if it wished to continue, had to sell the difficult sells. These sales included the remaining public utilities, electricity and the postal service. The potential sale of these assets would

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<sup>102</sup> Jane Kelsey *The New Zealand Experiment* (Auckland University Press, Bridget Willaims Books 1995) 41.

<sup>103</sup> Losing Sight of the Lodestar of Economic Freedom. *Wolfgang Casper*. New Zealand Business Round Table December 2002, 13.

bring the liberalisation program closer to home than any other asset sale. When the Minister of SOE's suggested selling New Zealand Post a subsequent Heylan Poll showed voters generally agree that the business sector uses assets more efficiently but that New Zealand Post was unique and should remain state run.<sup>104</sup> This type of public opinion left National with few options to convince the public that privatisation with electricity should progress, the justification based on the benefits of the market were not being accepted and it could no longer be claimed that asset sales were to pay back public debt.

The electricity industry itself added to the privatisation backlash. Electrocorp had been a model of an SOE in its pursuit of commercial goals. In 1987 when Electrocorp became an SOE it had employed 5999 workers and made a 141.2 Million dollar profit. By the 1991-92 year it had increased its profit to over 400 million dollars and decreased its staff to 3690. Electrocorp had boosted this profit figure by \$50 million dollars by investing in loss making companies to offset their tax liability. This profit put the return on investor's funds at just over 12%.<sup>105</sup> Despite this Electrocorp announced plans to increase bulk electricity prices by 20% over the next twenty years. Unsurprisingly this lead to a sustained outcry and a bi-partisan select committee. The committee reported back in 1992 with the finding that 50% of this increase would go to Electrocorp as profit and that the increase was just not justified.<sup>106</sup> The government broke the corporatisation rules and applied leverage on Electrocorps board, securing a more moderate increase. This process seemed to confirm the fears of both sides of the liberlisation program. Those who criticised the reforms could point to ECNZ as an example of the free market leading to generation companies abusing their position to gain super normal profits. Those advocating privatisation had confirmation that the SOE structure did not prevent government interference on political grounds. Two of the biggest proponents of privatisation were the ECNZ CEO Rod Deane and Board Chair John Fernyhough. Deane

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<sup>104</sup> NZ Herald, 25 April 1992.

<sup>105</sup> Kelsey above 124.

<sup>106</sup> Commerce and Marketing Select Committee *Report on the Inquiry into the Proposed Increase of Wholesale and Retail Electricity Prices*. (Feb 1992).

resigned citing government interference and Fernyhough did not seek reappointment for the same reason.<sup>107</sup>

Hostility towards Electrocorp was further compounded by an electricity shortage in 1992. The shortage required a 10% reduction in consumption by consumers at the start of winter.<sup>108</sup> ECNZ blamed a one hundred year drought, others blamed short-term profit maximising, a lack of prudent planning, the promotion of excessive consumption and the promotion of cheaper hydropower over more reliable geothermal resources. There were unsubstantiated claims of senior management bonuses being tied to profit or increase in electricity use. It was suggested that these factors lead to less storage of energy earlier in the year that contributed to the crisis.<sup>109</sup> The shortage was used as ammunition in the anti-privatisation debate. If the discipline of the market was meant to be good for consumers why was there a power shortage? Especially one that may have been a result of the market system rather than a victim of natural causes. The subsequent review laid only a small amount of blame at the director's feet. Its view was that this shortage was not caused by bad management practice, but by a very dry year. ECNZ could have implemented thermal energy at an earlier date but apart from that they operated as they should have.<sup>110</sup> The report's solution for the future years would lie in the market. By implementing a wholesale market for the supply of bulk electricity appropriate price signals would either encourage or limit consumption and avoid future power shortages.<sup>111</sup>

This early period of Nationals term included the conclusion of the Resource Management Law Reform.<sup>112</sup> This was a process of rationalising New Zealand's environmental law resulting in the Resource Management Act 1991. This project had

<sup>107</sup> Jane Kelsey *Rolling Back the State, Privatisation of Power in Aotearoa/ New Zealand*. (Bridget Williams Books, Wellington, 1993) 35.

<sup>108</sup> Dennis Welch "Power Without Responsibility" (April 19-25 2003) *The Listener* 16.

<sup>109</sup> Jane Kelsey *Rolling Back the State, Privatisation of Power in Aotearoa/ New Zealand*. (Bridget Williams Books, Wellington, 1993) 37

<sup>110</sup> The Electricity Shortage 1992: The Report of the Electricity Shortage Review Committee. (December 1992 Wellington).

<sup>111</sup> Electricity Shortage Review Committee, above, 79.

<sup>112</sup> Geoffrey Palmer. *Environmental Politics, A Greenprint for New Zealand* (John Mc Indoe Ltd, Dunedin, 1990), 91.

been implemented under Labour and was completed under a National government enjoying broad cross party support. The RMA seems to be an anomaly for its time for two reasons. Firstly its process was marked by broad consultation; over 3,500 submissions were received on the Bill as it went through the house.<sup>113</sup> Most of this interest came from environmental groups, with Treasury only beginning to criticise the Bill towards the end of its process.<sup>114</sup> Secondly, when the Act was eventually passed Treasury had only managed to get limited concessions to free market ideals that dominated the period.<sup>115</sup> Quite how the Act avoided this is unclear, Geoffrey Palmer's view was that environmental law reform "lacks political sex appeal."<sup>116</sup> It may have been that the Bill just wasn't noticed by many politicians and that Treasury didn't see it as a priority. The Act would go on to have a major effect on any major development involving natural resources in New Zealand. For electricity in particular the Act's potential to draw out resource consent being granted would provide a barrier to investment in new generation capacity.

### ***E National's Reform of Electricity.***

National's reform of electricity continued to build on the groundwork Labour had begun. National's primary goal was to finish the shift to corporate structures and to create competitive environment for each sector of the industry. The first sector to be reformed was retail. The Power Boards were corporatised in 1992 by the Energy Companies Act 1992. The boards registered as ordinary limited liability companies under the Companies Act. The board members introduced in 1990 were now managing directors of the new companies. The board's structures were now consistent with opening the market to

<sup>113</sup> Francis Castles, Rolf Gerritsen and Jack Vowels. *The Great Experiment: Labour Parties and Public Policy Transformation in Australia and New Zealand*. KHL Printing, Singapore, 1996) 121.

<sup>114</sup> P Ali Memon *Keeping New Zealand Green, Recent Environmental Reforms*. (University of Otago Press, 1993) 92.

<sup>115</sup> Mainly this was through transferable water abstraction permits, user charges for permit applications, performance bonds and environmental compensation.

<sup>116</sup> Palmer, above, 91.

competition which was introduced formally in 1993.<sup>117</sup> With this Act the elected Power Boards that had existed for over 70 years were gone. The Act implemented the light-handed regulation regime requiring the compulsory public disclosure of certain annual financial and performance information of the power companies.<sup>118</sup> Any business that owned both lines companies and retail companies had to account for these items separately.<sup>119</sup> This reform changed the public perception of Electricity. It was no longer a public utility but a commodity to be brought and sold on the market. The aim of this was that the new market would bring an increase in efficiency that would benefit consumers. Retailers would aim to enter new areas. Smaller boards would be forced to amalgamate with bigger competitors to remain competitive. Competition between these big retailers would force prices down. The success of the reforms in creating these cut-throat business entities was marginal. Ownership of the retail businesses did not quickly transfer to private companies, often remaining in Community Trusts and local body operators.<sup>120</sup> Often these trusts continued behaving in the similar manner as the Power Boards.

In 1994 Transpower was separated off from ECNZ and became its own SOE. This separated out transmission services from generation services. ECNZ was now in a position to be split into smaller companies and possibly sold. One generator owning the only national grid would have created an effective monopoly situation. Now that transmission was in its own company it could conceivably offer its services generators. It had taken 7 years but the National government had completed an important step in the reform of the electricity industry. Retail, generation and transmission were all in separate business structures.

The government had the structures in place but there was a lack of competition, the lines businesses in particular were beginning to look as though they may be taking advantage of their natural monopoly position. The government expressed this concern

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<sup>117</sup> Electricity Act 1992, 71.

<sup>118</sup> Electricity Act 1992, s 170.

<sup>119</sup> Electricity Act 1992, s 170

<sup>120</sup> See [http://www.med.govt.nz/ers/electric/chronology/chronology.html#P75\\_8843](http://www.med.govt.nz/ers/electric/chronology/chronology.html#P75_8843) last accessed 25 September 2003.

with the threat of separation of lines and retail business's in its 1995 Policy Statement on Electricity.

"If there is a clear and consistent pattern of abuse of natural monopoly line businesses, the Government would seriously consider requiring the ownership of lines businesses to be separated from the ownership of competitive activities, such as generation and energy retailing."<sup>121</sup>

In order to create competition in the generation market the government created the wholesale market (WSM) for bulk electricity. The government had been working towards this since the report on the 1992 shortage. The process had not run smoothly and original reports had been revised.<sup>122</sup> By 1995 the government had a set of final recommendations to work from. The basis of the market was that purchasers could find the real price of electricity and make usage decisions on that. A simpler version had been in place for the 1992 shortages, but had a price cap that limited its effectiveness.<sup>123</sup> The WSM is a voluntary system designed to work on straight supply and demand. It allows generators to compete directly against each other on the open market. The market was also aimed at avoiding future supply shortages. As lake levels drop the supply of electricity drops and the price of electricity increases. As the price increases large users will cut back on electricity lowering demand. The system is complemented with long-term sellable hedge contracts that can protect consumers from high spot prices and create an incentive to conserve power when spot prices are high. If users conserve power when there is a shortage they can sell the hedge contracts on the open market and make a profit. Ron McNamara, head of research and development at Electricity Marketing Company (The company in charge of the wholesale market) stated that the wholesale market would completely end the type of shortage that occurred in 1992.<sup>124</sup> The government moved to implement the market by splitting ECNZ into Contact Energy and ECNZ.<sup>125</sup> Contact Energy started operations in 1996 with 22% of the market. Six months later the proposed

<sup>121</sup> Government Policy Statement *Wholesale Electricity Reform, Regulation of the Electricity Lines Businesses* (Wellington, June, 1995)

<sup>122</sup> E.G. Baird, F.T and Culy, J. "Towards a Competitive Wholesale Electricity Market Wholesale Electricity Market Study Report" WEMS/5 October 1992

<sup>123</sup> Electricity Shortage Review Committee, above, 77.

<sup>124</sup> Dennis Welch "Power Without Responsibility" (April 19-25 2003) *The Listener* 19.

<sup>125</sup> See [http://www.maxbradford.co.nz/national\\_news/electricity/2001-11-01-Ele-Chrono\\_1986-2001.pdf](http://www.maxbradford.co.nz/national_news/electricity/2001-11-01-Ele-Chrono_1986-2001.pdf) 10. Last Accessed 28 May 2003.

wholesale market started operations. The split of ECNZ had other advantages for the government. There were now two major providers of generation capacity; the government could now sell one without risking a commercial operator taking advantage of a monopoly over electricity generation.

### *F The Influence of MMP.*

The liberalisation process had continued despite wide spread public opposition of the process. The process had split both parties; Jim Anderton left Labour to create New Labour and then to lead the Alliance, Peter Dunne had also left Labour to start the United Party (Later to become United Future) and Winston Peters left National and started New Zealand First. Parties had sustained both public image damage as well as internal division. The new parties appearing showed politicians unable to find parties with policies they agreed with. The New Zealand voting public was finding the same problem. Reforming governments under both Labour and National had pursued an ideological goal while almost completely ignoring the views of the electorate. David Lange commented on the fourth Labour government after leaving politics:

“The risk of being a reforming government, a radical government, is that you develop a taste for, in fact an enormous appetite for the adrenaline of change and you take it beyond what is acceptable and rational. We got thrown out of office because we went beyond that which was essential and we started to pursue things for their own sake and the sake of ideology.”<sup>126</sup>

Unfortunately for the voting public when Labour was “thrown out” of office because of its ideology-based policies they were replaced by a National party who continued the same policies. The reforming governments were extremely unpopular. Election results over this period tend to show massive shifts away from the government that was in power.<sup>127</sup> By 1993 voters were rejecting the major parties, both polled under 36% in that

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<sup>126</sup> *Listener* 19 August 1989

<sup>127</sup> In 1984 Labour came to power with a 17 seat majority, the 1987 election saw them re-elected with a similar majority. As the liberalisation program started to have effect National was re-elected with a 37 seat majority which was reduced to 1 seat in 1993. Elections New Zealand *Seats Held by Parties After General Elections, 1890-1993*. See <http://elections.catalyst.net.nz/elections/pandr/vote/seats-1993.html> last accessed 25 September 2003.



election. This was almost the lowest either party had polled in their history.<sup>128</sup> Despite these low results parties outside Labour and National held only two seats in the house. The ability of parties to form government with such small support from the electorate had been a criticism levelled at New Zealand's political system for some time.<sup>129</sup> Support had grown to such an extent that the 1993 election included a referendum on New Zealand's system for electing its government. The referendum was narrowly in favour of replacing the FPP system with a Mixed Member Proportionate (MMP) system.<sup>130</sup> The MMP system was aimed at ending results like those in the 1993 election where National could form government with only 35.1% of the vote. The expected result of the system was that government would have to be formed over multiple parties. This multi party approach should have reduced the effectiveness of the "Blitzkrieg" reform. The parliamentary whip system in particular would be less effective across party lines. MMP did seem to have an influence on stopping abuses of the democratic process, however arguably the electric industry was still to provide the last example of the "Blitzkrieg".

The first MMP election was held in 1996. On election night Winston Peters and New Zealand First found themselves in the position to return either National or Labour to government. Peters went into negotiations with both parties, despite campaigning on a "No National" platform. A coalition government was formed between New Zealand First and National.<sup>131</sup> Peter's other main platform was a promise to stop asset sales. The resulting Coalition Agreement named certain state owned assets that could not be sold. This included both ECNZ and Contact Energy. Under this arrangement the coalition government continued the reform of electricity.

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<sup>128</sup> Elections New Zealand *Seats Held by Parties After General Elections, 1890-1993*. See <http://elections.catalyst.net.nz/elections/pandr/vote/seats-1993.html> last accessed 25 September 2003.

<sup>129</sup> The lead up to this referendum had begun in the 1950's. By 1985 there had been a Royal Commission into the electoral system. While the "Blitzkrieg" reforms may have influenced voters it was not the trigger for the movement to change the system. See Paul Harris, Chief Executive Electoral Commission of New Zealand *New Zealand's Change to MMP* See [http://www.aceproject.org/main/english/ei/eiy\\_nz01.htm](http://www.aceproject.org/main/english/ei/eiy_nz01.htm) for more information on the background to the change in electoral system. Last accessed 25 September 2003

<sup>130</sup> Harris, above, see [http://www.aceproject.org/main/english/ei/eiy\\_nz01.htm](http://www.aceproject.org/main/english/ei/eiy_nz01.htm) last accessed 25 September 2003.

<sup>131</sup> "NZ First Picks National" (11 December 1996) *The Dominion*, Wellington.

## *G A Better Deal for Consumers.*

In 1998 the Coalition released the electricity package "A Better Deal for Consumers". The package was designed to ensure consumers were sent the proper signals from the market and that there was constant downward pressure on electricity prices.<sup>132</sup> The package reflected the politics of the time. New Zealand First stopped assets sales but did not object to the general direction of the reforms. So while the package did not propose the sale of state owned generators<sup>133</sup> it did split ECNZ into three separate companies in order to increase competition.<sup>134</sup> The package split the industry into two categories. Natural monopolies such as the lines companies and transmission were subject to increased light-handed regulation and the threat of price control. Competitive industries like generation and retail would face reforms to increase the level of competition.

Lines companies faced stronger light-handed regulation with more stringent requirements under the Electricity (Information Disclosure) Requirements Act 1994. These measures were aimed at providing better-cost allocation for the distribution companies financial reporting.<sup>135</sup> The reforms introduced the threat of price control for distribution.<sup>136</sup> It was felt that lines companies were taking advantage of their natural monopoly position. The threat of regulation under the Commerce Act seemed a drastic one to take, however its potential was always considered a part of the light-handed

<sup>132</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) See <http://www.med.govt.nz/ers/electric/blueprint/index.html> Last Accessed 27 April 2003.

<sup>133</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint01.html#P217\\_8590](http://www.med.govt.nz/ers/electric/blueprint/blueprint01.html#P217_8590)

<sup>134</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint02.html#P302\\_12262](http://www.med.govt.nz/ers/electric/blueprint/blueprint02.html#P302_12262)

<sup>135</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P635\\_33457](http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P635_33457)

<sup>136</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P946\\_52384](http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P946_52384)

regime in relation to the electric industry.<sup>137</sup> At this point the only regulations affecting the industry were the Fair Trading Act 1986, the Commerce Act 1986, and the Resource Management Act 1991.<sup>138</sup>

The retail market came under scrutiny; the general view was that privatisation had not brought the benefits it should have. The Electricity Industry Reform Act banned any company from owning a lines operation as well as either an electricity retailing or generation operation.<sup>139</sup> It was still acceptable for a generator to own a retailer and vice versa. The decision was focused on increasing competition between retailers by giving all retailers access to distribution lines and making retailers more responsive to customer demands.<sup>140</sup> The split would also deal with the growing concern that company mergers could lead to large vertically integrated monopolies over de facto franchise areas. At present a company could gain control of retail, distribution and supply for the area and have little, if any, market pressure on them.<sup>141</sup> The split of companies was a drastic measure to take. Economist Ross Paterson commented at the time that it "...was necessary only because light handed regulation had failed."<sup>142</sup> It was a measure that would be considered expropriation under either the Multilateral Agreement on Investment<sup>143</sup> or NAFTA<sup>144</sup> and would be cause for compensation. TransAlta for one complained very loudly and threatened capital flight if the legislation was enacted.<sup>145</sup> The separation of these business structures is a prime example of the government's unwavering belief in the market. Rather than introduce regulation to control how the market operates the government would take this drastic and unpopular action to create a

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<sup>137</sup> Ministry of Commerce, Energy and Resource Division, Energy Policy Group, *Light handed Regulation of New's Zealand's Electricity and Gas Industries* (Ministry of Commerce, Wellington, October 1995), 1.

<sup>138</sup> See <http://www.nzelectricity.co.nz/C1Overview.htm> Last Accessed 28 April 2003

<sup>139</sup> Electricity Industry Reform Act 1998, Parts 1-5.

<sup>140</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P758\\_40850](http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P758_40850)

<sup>141</sup> Ministry of Economic Development "A Better Deal for Consumers" (Wellington, 1998) [http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P760\\_40916](http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P760_40916)

<sup>142</sup> Ross Paterson "Light handed Regulation in New Zealand Ten Years On" (1998) *Competition and Consumer Law Journal* 6(2), 155.

<sup>143</sup> Multilateral Agreement on Investment, section iv.

<sup>144</sup> North American Free Trade Agreement, Article 1110

<sup>145</sup> *Press*, 2/6/98, "TransAlta threatens to pull out of New Zealand", p.18.

free market subject to competitive forces. Paterson's assertion that this showed the failure of light handed regulation is correct, but perhaps should be qualified. The split was necessary because light-handed regulation failed to work on these structures. The government set about changing the industry structure to one that would work without heavy-handed regulation. Once structural change was achieved the government would again regulate primarily through light-handed regulation. When the legislation passed it was accepted by the industry, most businesses staying with their monopoly lines businesses. The four exceptions, (Tansalta, Contact Energy, ECNZ and Trustpower) were to become the main retailers in the country, scrambling to amass as many customers as possible.<sup>146</sup> The retail reforms were completed by an expectation that the industry would set up a system for swapping retailers. The industry itself had made this very difficult. The reforms made it clear that the government expected them to provide a system for swapping retailer's or face regulation.<sup>147</sup>

The government had aimed this package at consumers who were still unhappy with the industry, however the underlying approach had not changed. The package aimed at increasing competition between the industries companies. The benefit to consumers would come as a result of this increased competition. The process for passing legislation seemed quite similar to pre-MMP government. The Act was passed on the 3<sup>rd</sup> of July 1998 with a very tight time frame, the select committee process was held over three days. The select committee terms of reference did not allow it to consider submissions on the substantive policy of the Act.<sup>148</sup> A total of 224 submissions were received a majority of which were not in favour of the Act. Despite this the Act went ahead.

The aim that this package would dampen public criticism was largely undermined later that year. On the 20 February 1998 Auckland's main power cables failed cutting

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<sup>146</sup> While these four would dominant there was in fact 7 retailers down from 39 at the start of the year

<sup>147</sup> Ministry of Economic Development "*A Better Deal for Consumers*" (Wellington, 1998)

[http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P924\\_50620](http://www.med.govt.nz/ers/electric/blueprint/blueprint03.html#P924_50620)

<sup>148</sup> Submissions could only concern technical and implementation measures.

power to its CBD.<sup>149</sup> The official investigation blamed the unusually hot weather.<sup>150</sup> However documents released after the crisis showed that Mercury had known that the cables were reaching the end of their life and carrying capacity.<sup>151</sup> Generally consumers raised questions about the management of Mercury and whether they were putting profit before power security.<sup>152</sup> The fact that it was Mercury Energy at the center of the scandal was embarrassing for the government. The central government had wished to privatise Mercury in order to claim full benefits of a competitive market. Local authorities had resisted. Eventually the central government had forced Mercury into an arrangement where they were owned by a community trust, but controlled by one of New Zealand's largest law firm's.<sup>153</sup> Under this arrangement Mercury embarked on an aggressive strategy to take over neighboring companies. This had led to a hostile and public 4-year battle with Utilicorp over the other Auckland power Company, the New Zealand Power Company in the years leading up to the shortage.<sup>154</sup> The incident raised questions, had Mercury spent money on takeover bids instead of ensuring that infrastructure was correctly maintained? Was the failure of the cables a result of the reform's and free market behavior? This last question becomes even more apparent when Auckland's experience is compared to Christchurch's Southpower. Christchurch City Council owns Southpower and the company has been running well and returning healthy profits back to the council. It appears that Council ownership did not lead to an inefficient retailer. As with the experiences with ECNZ in 1992 the proposition that a market based electricity system would provide the best result to New Zealanders was again undermined.

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<sup>149</sup> Ministerial Inquiry *Auckland Power Supply Failure 1998: The Report of the Ministerial Inquiry into the Auckland Power Supply Failure* (1998) 21.

<sup>150</sup> Ministerial Inquiry *Auckland Power Supply Failure 1998: The Report of the Ministerial Inquiry into the Auckland Power Supply Failure* (1998) 116.

<sup>151</sup> "Mercury had warning signals- Document" (3 March 1998) *Waikato Times* Waikato

<sup>152</sup> "Failures Related. Leader to the Editor" (11 March 1998) *The Dominion*, Wellington

<sup>153</sup> The Auckland Consumer Energy Trust was to originally hold 100% of the capital in Mercury, however under the establishment plan 25% was held by law firm Russel McVeagh with the intention that this would be made available in a public offering. Under the establishment plan this 25% gave Russel McVeagh a 49.5% of the voting rights and the ability to appoint 6 of the 11 directors. The Trust submitted to the inquiry that despite their 75% shareholding that they had no role in the policy formulation of Mercury Energy. See Auckland Energy Consumer Trust *Submission to Ministerial Inquiry into the Auckland Power Supply Failure* (1998).

<sup>154</sup> "Power play companies compared to alligators" (12 September 1997) *Christchurch Press*, 25.

## H *The Last Move of the Blitzkrieg*

In 1999 the coalition broke down over the proposed sale of Auckland Airport.<sup>155</sup> National remained in power as a minority government propped up by Act, United Futures Peter Dunne, Alliance defector Alimein Kupo and eight former New Zealand First MP's. The breakdown freed National from its coalition undertaking not to sell national assets. The SOE (Contact Energy) Amendment Bill was passed under urgency avoiding the need for select committee. The Act gave the government 2 years to sell Contact energy.<sup>156</sup> Contact energy was sold in 1999 through a combination of public share issue and a 40% sale to US based Edison Mission Energy.<sup>157</sup> The sale was controversial, the eight former NZ first MP's and Alimein Kupo had all come from parties against asset sales. Many of these MP's only obtained a seat in parliament through the list vote of these parties. On this basis the government did not appear to have the mandate sell Contact energy. Arguably this was the last move of the "Blitzkrieg". The sale did not have public support; it was passed rapidly without a select committee just before an election National was likely to lose.

Latter that year National was voted out of office. This was to mark a turning point in the philosophy of the government since the reforms started in 1984. The industry was largely unrecognisable from when the reforms started. Generation was fragmented and partially private, transmission was now a separate government owned entity, distribution lines were private companies and retail was now a series of commercial venture. Government overview was minimal; New Zealand was now one of the few countries in the OECD with a Minister of Energy with no Ministry to support him.<sup>158</sup> Despite these changes the reforms had not completed its process in a neo-classical sense. There was a large amount of government ownership, the generation was split up but not enough to create a competitive environment, transmission was a government owned monopoly and there were still serious questions over how competitive the retail and distribution markets

<sup>155</sup> "Chronology of a Coalition Break-up" (19 August 1998) *The Independent*.

<sup>156</sup> "Govt Ridiculed for Fast Track Bill." (2nd December 1998) *Evening Post*, Wellington 14.

<sup>157</sup> See <http://www.med.govt.nz/ers/electric/chronology/chronology-01.html#TopOfPage> last accessed 27 April 2003

<sup>158</sup> Dennis Welch "Power Without Responsibility" (April 19-25 2003) *The Listener*, 19

were. Electricity had proven to be one of the most difficult state departments to reform. Practically it took a long time to convert this government department into a competitive industry. Politically general resistance to the reforms had time to organise against the process and slow the speed of the reforms. The introduction of MMP proved to be a large barrier. The reforming National government found that it no longer had the political ability to continue with fundamental elements of the reform process. 15 years of reform had only been able to move the industry to a point where the next step in neo-classical reform would be the large-scale privatisation of government assets in generation. For the reformist's the election of the Labour lead coalition stopped this process and for the first time in 15 years began a process of partial re-intervention into the electricity industry.

#### **IV STATE INTERVENTION AS A POLICY OPTION.**

Labour was re-elected in 1999 as the leader of the coalition with the Alliance party. Public concern with the electricity industry had not abated by this time. The Auckland power crisis was still fresh in the public's mind and consumers were still being frustrated when they tried to change retailers. Commenting in 2000 Consumer Institute chief executive David Russell, noted that complaints about electricity retailers had surpassed criticism of banks, this was considered quite a feat at the time.<sup>159</sup> The government itself was obviously unhappy with the structure and performance of the industry and had begun to look at re-ordering the current arrangements.<sup>160</sup> Labour's view was that the changes in the electricity industry had not brought consumers the benefits that they should have and initiated a Ministerial Inquiry to find out why.<sup>161</sup> The inquiry had extremely wide terms of reference and its final report made 53 recommendations on all aspects of the industry. Overall the inquiry acknowledged that the market system was the best approach to the industry but recommended government regulation in some

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<sup>159</sup> "Judgement Day for Electricity Market Regime" (28 August 2000) *NZ Infotech Weekly*, Wellington

<sup>160</sup> Minister of Energy, Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000)

<sup>161</sup> Minister of Energy Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000)

circumstances. The reports recommendations were all implemented either directly or in modified form with the 2000 Power Package.<sup>162</sup>

#### A *The 2000 Power Package.*

The package released a new Government Policy Statement for electricity. The governments overall objective for the industry was that electricity was delivered in an efficient, fair, reliable and environmental sustainable manner. The main point of the policy statement was its expectation for future industry action on governance arrangements. An Electricity Commission (Commission) would be developed to replace the three existing governance institutions: New Zealand Electricity Market (NZEM), Metering and Reconciliation Information Agreement (MARIA) and Multilateral Agreement on Common Quality Standards (MACQS).<sup>163</sup> The role of the Commission would be to consolidate these agreements and develop more rules in line with a set of guiding principles set out in the policy statement.<sup>164</sup> Consistent with the overall objective outlined above, the Government was seeking the following specific outcomes:

- a. energy and other resources are used efficiently, and in particular, hydro spill is minimised;
- b. risks relating to security of supply, in particular the risks of dry years and inadequate transmission and distribution security, are properly and efficiently managed;
- c. the full costs of producing and transporting each additional unit of electricity are signalled so that investors and consumers can make decisions consistent with obtaining the most value from electricity;
- d. delivered electricity costs and prices are subject to sustained downward pressure;

<sup>162</sup> Minister of Energy Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000)

<sup>163</sup> Ministry of Economic Development *Government Policy Statement: Further Development of New Zealand's Electricity Industry*. (Wellington, 2000) 3.

<sup>164</sup> Ministry of Economic Development *Government Policy Statement: Further Development of New Zealand's Electricity Industry*. (Wellington, 2000) 2.



- e. the quality of electricity services, and in particular trade-offs between quality and price, should as far as possible reflect customers' preferences;
- f. transmission losses and constraints are signaled to ensure that overall costs to the economy, including the costs of insufficient competition in local regions, are minimised; and
- g. greenhouse gas emissions are minimised.<sup>165</sup>

The Commission would ideally be an industry based self-governing unit. If the industry did not act the government threatened to set up its own body.<sup>166</sup> This was a real threat with the Electric Industry Act 2001 providing the government with unprecedented powers to set up a Crown Entity to fulfil the role.<sup>167</sup> The government initiated the Electricity Governance Establishment Committee (EGEC) to facilitate the Commission's development.<sup>168</sup>

The power package turned to monopoly lines companies. The inquiry had recommended that the government permit the Commerce Commission to have powers to set prices for the lines industry.<sup>169</sup> While this measure had been threatened under the National it was implemented by the Labour lead coalition under the Electricity Industry Act 2001.<sup>170</sup> Under subpart 1 of part 4(a) of the Act the Commerce Commission is required to set thresholds for the declaration of control in relation to the lines companies, assess businesses against set thresholds, determine whether these thresholds have been breached and then make a determination of whether or not to make a declaration of

<sup>165</sup> Ministry of Economic Development *Government Policy Statement: Further Development of New Zealand's Electricity Industry*. (Wellington, 2000) 2.

<sup>166</sup> For future reference the governments powers: create a complaints resolution system for consumers; prepayment meters; transition arrangements for insolvent electricity retailers; the connection of generation to distribution lines; hydro spill; hedge prices; dispute resolution procedures for disputes between industry participants; and the enforcement of electricity governance regulations, whether or not the EGB is established, but if it is established these regulations and rules can only be made after having had regard for any EGB recommendation.

<sup>167</sup> Garry Downs "Further Wake-up Call for the Electricity Industry" (Bell Gully Publications, 2001) see [http://www.bellgully.com/publications/elec\\_2001\\_01\\_wakeup.html](http://www.bellgully.com/publications/elec_2001_01_wakeup.html) last accessed 27 September 2003

<sup>168</sup> See [http://www.med.govt.nz/ers/electric/chronology/chronology-01.html#P215\\_27687](http://www.med.govt.nz/ers/electric/chronology/chronology-01.html#P215_27687) last accessed 27 September 2003

<sup>169</sup> See <http://www.med.govt.nz/ers/electric/chronology/chronology-01.html#TopOfPage> Last Accessed 27 April 2003

<sup>170</sup> Minister of Energy, Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000) Press Release

control in relation to the business. The thresholds were ultimately based on both price and quality standards.<sup>171</sup> Any breach could lead to price control by the Commerce Commission.

As with the previous reforms this package was aimed at consumers. Labour's approach was quite different to previous governments. Previous reforms had continued to de-regulate, with the philosophy that increased competition would benefit consumers. Labour's approach was to regulate to give consumers a better deal. Apart from those measures outlined above the inquiry recommended a number of other measures. These included requiring retailers to offer domestic consumers one low rate fixed charge rate, amending the Consumer Guarantees Act to cover electricity,<sup>172</sup> requiring retailers to have prepaid meters available to consumers and implementing a consumer complaints system similar to the insurance ombudsman.<sup>173</sup>

Overall the reforms had shown elements that would be influential in future reforms. Firstly, that the government was unhappy with the state of the electricity industry. The media statement released with the document included this statement.

"The Power Package puts the heat on the electricity industry, this package will sort out the mess left by the previous Government and give consumers the deal they deserve"<sup>174</sup>

This is very strong language aimed at both the National party and the industry. Secondly the government would intervene where it perceived the industry cannot produce desirable results.

Following this package there was another shortage in 2001. The predication that the WSM would stop supply shortages proved to be incorrect. Confusingly the

<sup>171</sup> See Commerce Commission *Regulation of Electricity Lines Businesses, Target Control Regime, Draft Assessment and Inquiry Guidelines (Process and Analytical Framework)* (Wellington, 2003) 4.

<sup>172</sup> See *Electricity Supply Association of New Zealand v Commerce Commission and Consumers Institute* (1998) 6 NZBLC 102. In this case the High Court decided that electricity was not covered under the Consumer Guarantee Act 1993.

<sup>173</sup> Minister of Energy, Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000) Press Release

<sup>174</sup> Minister of Energy, Peter Hodgson "A fair Deal for energy Consumers" (3 October 2000) Press Release

subsequent Post Winter Review found that the wholesale market had worked as it was supposed to, however the shortage could have been averted by if the industry had implemented the governments Policy Statement of 2000.<sup>175</sup> Specifically the lack of progress towards industry governance was said to be a concern. The government appeared to be becoming exasperated with the industry, Energy Minister Peter Hodgson was quoted during the shortage:

“The two questions in front of me are: how are we going to get through this winter, and next? Second question: and why am I asking the first question all the bloody time?”<sup>176</sup>

The following year the government re-issued its policy statement. This statement was largely unchanged from the 2000 statement.<sup>177</sup> The government was soon to put into action its view that government regulation would be required where the industry failed to act.

### **B     *The Electricity Commission***

In 2003 the EGEC reported back that the industry had rejected a self governing Commission. The industry solution had failed. Self-governance was not wanted by most of the big players in the industry.<sup>178</sup> The timing of this rejection proved to be important, coming in the middle of another power shortage. The decision by the government to use its powers under the Electricity Amendment Act to implement an Electricity Commission was made public on the 20 May 2003.<sup>179</sup> The government released a discussion document on the structure of the proposed Commission. It quickly became apparent that the government Commission was quite different to the one that had been rejected by the industry. The government had decided that industry solutions had not only failed to

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<sup>175</sup> Minister of Energy *Post Winter Electricity Review* (Wellington, 2001) 2.

<sup>176</sup> Dennis Welch “Power Without Responsibility” (April 19-25 2003) *The Listener*, 19.

<sup>177</sup> Paragraph 15 of the December 2000 statement was amended to require public disclosure of generator offers after 2 weeks (instead of 3 months).

<sup>178</sup> Cabinet Paper “Proposal to Establish an Electricity Commission” (May 2003) See <http://www.med.govt.nz/ers/electric/supply-security/cabinet/commission-proposal/commission-proposal-01.html> Last Accessed 13 July 2003.

<sup>179</sup> Minister of Energy, Peter Hodgson and Minister of Finance Dr Michael Cullen “Electricity Commission Will Deliver Supply Security” (Wellington, 20 May 2003) Press Release.

develop a self-governing structure but had also failed to ensure New Zealand had a secure electricity supply. The government's Commission would not only develop a rule book for industry practice but would have the added role of securing supply in one in sixty dry years.<sup>180</sup>

The Commission's role in securing supply would be based in the market. The Commission would not own any generation capacity; it would contract with existing generators to ring fence reserve energy. Reserve energy tends to have low capital, but high marginal costs due to the requirement that fuel is likely to be stored for long periods.<sup>181</sup> The current market arrangements made it uneconomical to store fuel for shortage situations. The aim of the Commission is that the contracts will make reserve generation economically viable for generators to supply. When lake levels fall the Commission will exercise the contracts and sell electricity back through the wholesale market increasing supply and avoiding shortages. This is seen as a fine balancing act between ensuring security of supply and keeping market incentives. If the price is too low then the market will have less incentive to invest in base capacity, if it is set too high it will not be used in circumstances where it should have been. It is expected that the Commission will have sufficient capacity to effectively cap the price of electricity at the rate they release except in extremely rare circumstances.<sup>182</sup> In this way the Commission is also expected to fulfill another role in the market. The spot price of electricity has proven to be much more volatile than expected. In the 2003 shortage prices hit 70-cents per kilowatt-hour, up from the normal 6-cent per kilowatt-hour.<sup>183</sup> The Commission's role is also expected to have an element of price smoothing to avoid these huge variations.

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<sup>180</sup> New Zealand Electricity Market, The Multi-Lateral Agreement on Quality Standards, and The Metering and Reconciliation Information Agreement. See <http://www.jadeworld.com/JadeSystems/csmaria.htm> Last Accessed 13 July 2003

<sup>181</sup> Ministry of Economic Development *Reserve Generation: A Discussion Document* (Wellington May 2003) 4.

<sup>182</sup> Ministry of Economic Development *Reserve Generation: A Discussion Document* (Wellington May 2003)

<sup>183</sup> Dennis Welch "Power Without Responsibility" (April 19-25 2003) *The Listener*, 18.

While the major part of the discussion document focused on the reserve contracts the Commission would also have a "tool-box" of powers. This would include the power to require that generators hold a minimum of dry year reserves and to require that retailers hold long-term financial contracts. This move is likely to be a reaction to the 2001 Post Winter review that found that retailers had failed to adequately protect themselves with hedge contracts. The Commission would also have the power to ensure that the retailers and large users have systems in place to reduce demand when spot prices begin to rise.<sup>184</sup> The Commission's regulatory power is not to be underestimated, there was a concern that the Commission's powers are broad enough to conflict with the Commerce Commission. The Commission will be self-funding through a levy of about .5c per kilowatt-hour.<sup>185</sup> At present prices are around 5 cents per kilowatt-hour.<sup>186</sup> This would put the price of electricity up by about 10%. Any time that the Commission sells electricity on the market this money will be used to offset its future running costs.

The Commission proposal showed that the government was prepared to get involved in the industry in a hands on manner. This was a major change after the focus of the last 15 years was on how to remove government influence from the market. Soon after this the government announced that it would act to speed the resource consent process for a generation project. Meridian Energy first proposed project Aqua in 2001. Project Aqua is hydro generation scheme on lower Waitaki River, the system uses eight canals to link six hydro stations and requires diverting part of the river flow into the canals. These canals will run for approximately 60 kilometers. A project of this magnitude would affect anybody from farmers, to local iwi, to recreational users of the river system. Not surprisingly it ran into problems gaining resource consent under Resource Management Act. On the 11<sup>th</sup> September the government announced that it would "intervene in the process of allocating water in the Waitaki catchments, in order to ensure that local, regional and national needs are considered."<sup>187</sup> The government has indicated that they

<sup>184</sup> Ministry of Economic Development *Reserve Generation: A Discussion Document* (Wellington May 2003) 4.

<sup>185</sup> Ministry of Economic Development *Reserve Generation: Discussion Document* (Wellington, 2003) 5.

<sup>186</sup> See [http://www.comitfree.co.nz/fta/price\\_index.summary](http://www.comitfree.co.nz/fta/price_index.summary) Last Accessed 13 July 2003

<sup>187</sup> Minister for the Environment, Hon Marion Hobbs "Environment Minister to Call in Waitaki Water Applications" 11 September 2003, Press Release.

would pass special legislation to by-pass the Resource Management Act. Clearly the view was that building new generation capacity was something that outweighed the benefits of resource consent process. It was a move that had some commentators comparing it to the Muldoon government's legislation to overturn the Environmental Court ruling that refused to allow the building of the Clyde dam. The connection between these two acts can be exaggerated, however it does show the government avoiding established systems to provide a practical response to an issue.

5 days after this the government released its draft Policy Statement on the Electricity Governance. The document outlined in much greater detail the role of the Commission and its powers. Minister of Electricity the right honorable Peter Hodgson set out the Commission's key tasks:

- ensuring New Zealand's electricity supply is secure, with adequate reserve generation for dry years;
- establishing a decision-making process and transmission pricing methodology for investment in the national grid; and
- improving demand-side participation in the wholesale market and consumer protection measures, such as minimum terms and conditions for consumer contracts.<sup>188</sup>

The aim of the Commission should be on using the "powers of promotion and persuasion" to achieve these measures, but it will regulate to get required outcomes if that is necessary.<sup>189</sup> The purpose of the Commission is extremely broad, it appears to have turned into catch-all for the government policy on electricity that has no other obvious administration point.

For consumers the Commission will work in tandem with the Ministry of Consumer Affairs on a variety of measures. Firstly contracts of supply will have a minimum set of terms and conditions aimed at increasing transparency and protecting

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<sup>188</sup> Minister of Energy, Hon Pete Hodgson "Government Policy Statement Sets Agenda for New electricity Commission" (14 September 2003) Press Release.

<sup>189</sup> Ministry of Economic Development *Government Policy Statement on Electricity Governance (Draft)* (Wellington 14 September 2003) 4.

consumers. The Commission will also set regulations for paying for electricity, including a low fixed charge option for small users, a requirement for pre-paid meters and a limit on bond payments required from new customers.<sup>190</sup> The proposals also suggest a requirement that a complaints system is developed that is broader than existing arrangements under the Electricity Complaints Commission and the Electricity Consumer Code of Practice.<sup>191</sup>

The Commission's role in security of supply is largely the same as is set out above. The documents main point is to release the detail of the proposed Commission. Supply is to be met in 1 in 60 dry years, without the need to resort to savings campaigns and minimising any market distortions.<sup>192</sup> The decision to release electricity will be based on clear objective measures. Electricity will be released either when the spot price reaches 20 cents a kilo-watt hour or the variable payments that have been contracted for, whichever is higher. The only exception for this will be when the lake levels enter certain "zones" and the spot price is not above 20 cents a kilowatt-hour.<sup>193</sup> These "zones" will be developed and published by the Commission. The "zones" are the Commission's estimates of minimum hydro storage levels required throughout the year to avoid a 1 in 60 dry year. A secondary zone would provide for a conservation campaign on top of the release of reserve electricity. Reserve generation will initially be tightly ring fenced, but this will be reviewed after a period of two – three years. The proposal also recognises the risk that this system may provide an incentive to run hydro levels at a low level in order to rely on reserve generation. The Commission is expected to monitor this situation and if necessary request extended powers from the Minister of Energy. This could include powers to require generators to have a minimum of reserve generation or fuel, to force generators to offer minimum levels of contracts to buyers and set minimum requirements on retailers and users with direct grid access to maintain minimum levels of contract

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<sup>190</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 6.

<sup>191</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 7.

<sup>192</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 7.

<sup>193</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 10.

cover with generators and firm demand side arrangements.<sup>194</sup> The Commission's regulatory power will also extend to the hedge market. The hedge market has never operated to its full effectiveness. The Commission is now proposed to have powers under the Electricity Act to recommend regulations for the minimum levels of hedge contract to be available from generators.

The government document expressed the view that retail competition had improved, with most users in major centers having a choice of electricity retailers. Even so retail was not as competitive as it could be. The Commission's role for retail would be to increase competition in retail. This could include regulation, the government has indicated increasing powers that the Commission has under the Electricity Act. These extended powers would include measures to standardise contracts on lines access and access to meters. It also proposes extra measures to assist retailers in swapping between retailers. The powers to make a minimum amount of hedge contracts available was aimed at diminishing generator/retail companies from charging unreasonably high prices for hedge contracts and preventing other retailers entering the market.<sup>195</sup>

Apart from those outlined above, the Commission's role also includes producing outcomes under this government's renewable energy and energy efficiency strategies, the Energy Policy Framework, the National Energy Efficiency and Conservation Strategy and Climate Change Work Program.<sup>196</sup>

### **C     *The Changing Role of the State.***

The proposed system has not been without its critics. A major criticism is its expense. Taking the view that the Commission had run from 1992 to 2002 and that it had been

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<sup>194</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 10

<sup>195</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 18.

<sup>196</sup> Ministry of Economic Development *Government Policy Statement of Electricity Governance (Draft)* (Wellington 14 September 2003) 1.



able to save all the economic loss caused by shortages in this period<sup>197</sup>, the system would have cost approximately \$1.44 Billion while the economic loss to the economy was estimated at \$700 million.<sup>198</sup> There are other commentators who have suggested in strong terms that the Commission is a fundamental mistake. Trustpowers submission on the *Reserve Generation Discussion Document* questioned the basis of the Commissions new role.

“We believe the market's bias will be to tend to deliver security to well above a 1 in 60 level without calls for conservation if prices are allowed to balance supply and demand and if contractual rights are more widely and specifically defined. The root causes of the actual lack of responsiveness of these key plant are considered to relate to the lack of inter-generator back-up contracts (e.g. between Genesis and Meridian) and the thinness of contract markets overall, and the lack of commercial performance pressures on the state owned companies.”<sup>199</sup>

Other submissions agreed with Trustpower. The submission from the Energy Federation of New Zealand stated that government ownership of generation should not exceed 20% of the market.<sup>200</sup> The Energy Federation is the New Zealand committee member of the World Energy Council. The submission follows the 2001 World Energy Council publication *Electricity Market Design and Creation in Asia Pacific*. This report found that for a truly competitive energy market no generator should have above 20% of the market.<sup>201</sup> The submission is clear, the role of Commission should be improving the current market rather than intervening. Richard Tweedie from Todd Energy supported the view that the market was not run competitively. “The four major generators all have

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<sup>197</sup> This is extremely unlikely, the elevated spot price caused by the shortage would result in a large amount of economic loss to the economy. Further this period had two 1 in 60 dry years, this indicates that either this loss is unlikely to be as high in future periods, or that the problem lies in base capacity and the reserve generation is an extremely inefficient way to deal with this problem.

<sup>198</sup> John Noble “Solutions to Power Crisis, or Just Damage Control?” *The Independent*, (28 May 2003). Wellington 8.

<sup>199</sup> Trustpower *Submission to Ministry of Economic Development on Reserve Generation*. (Submission to Ministry of Economic Development, June 2003)

<sup>200</sup> Energy Federation of New Zealand *Submission from the Energy Federation of New Zealand*. (Submission to Ministry of Economic Development, June 2003)

<sup>201</sup> World Energy Council *Electricity Market Design* (1999, London) See [http://www.worldenergy.org/wec-geis/publications/reports/emd/exec\\_summ/default.asp](http://www.worldenergy.org/wec-geis/publications/reports/emd/exec_summ/default.asp) Last Accessed 13 July 2003

market power and can literally nominate any price."<sup>202</sup> These statements clearly agree with the approach of the original reforms. The government's role should be in correcting current market arrangements. By implementing the Commission the government will not deal with the fundamental problems with the industry.

The government themselves have been critical of the market structures. Minister of Finance Dr Michael Cullen stated in the media release on the announcement of the proposed Commission.

"Electricity supply security has become a serious concern to the Government, business and the wider community. For sustainable economic growth New Zealand needs a more reliable and fairly priced supply of electricity than the current electricity market arrangements have delivered."<sup>203</sup>

Where the government differs from the criticisms outlined above is that they clearly do not see a solution to supply security lying in further deregulation and privatisation. The government has in fact ruled out any further asset sales.<sup>204</sup> The government's response to the security of supply is to regulate for the required outcomes. This response to market problems is not isolated to the electricity industry. Since 1999 Employment laws have been amended to reintroduce the possibility of collective bargaining,<sup>205</sup> a state owned retail bank has been set up in response to private banks poor service and accident insurance has been re-nationalised. Despite regularly stating that the market is preferred to government regulation they have continued to reverse many elements of the free market reforms. The situation shows a marked change in approach compared to the governments between 1984 and 1999.

The best illustration of the underlying differences between the current approach and the approach of the reforming governments can be found in the introduction and

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<sup>202</sup> Michael Foreman and John Redward "Who or What is to Blame and What Can Be Done?" (7 May 2003) *The Independent* Wellington 5.

<sup>203</sup> Minister of Energy, Peter Hodgson and Minister of Finance Dr Michael Cullen "Electricity Commission Will Deliver Supply Security" 20 May 2003, Press Release.

<sup>204</sup> Losing Sight of the Lodestar of Economic Freedom. *Wolfgang Casper*. New Zealand Business Round Table December 2002,

<sup>205</sup> The Employment Contracts Act effectively removed Collective Bargaining.

subsequent amendment of the Commerce Act by the fourth Labour Government and Labour-Alliance coalition. The Commerce Act was passed in 1986 to increase competition in newly privatised industries. Its purpose at the time was: "An Act to promote competition in markets within New Zealand."<sup>206</sup> For the reforming government competition and the free market became the overriding aim of all the reforms. As the government could only come a distant second to any competitive free market outcome its role was limited to removing barriers to competition such as regulation, state ownership or anti-competitive structures. This was an ideology-based policy that was seldom questioned; any undesirable results were put down to any remaining state influence or anti-competitive structures rather than a problem with the underlying ideology. For reforming governments creating competitive environments became an end of itself. This led to some quite extreme measures, the separation of the lines and retail companies being the most obvious example. In that case the reforming government saw the problem as lying in the structure of the market, not in the dangers of bringing the free market to natural monopoly assets. When Labour was re-elected in 1999 it rejected the view that competition produces the best outcome at all times. In 2001 the Commerce Act was amended, its new purpose reads as follows: "The purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand."<sup>207</sup> The change is a subtle one, but is illustrative as it shows that this government expects competition to produce a certain result. Competition is a means to obtain a policy goal; it is not something that is an end in its own right. The approach is a result based one, if competition does not provide these results then other measures will be used. In many cases the government realises that the free market produces results so will primarily attempt to use the free market. Telecommunications, for example, is left largely to the free market with only the Commerce Act being used for regulation. However in circumstance where the free market is not operating well the government will intervene. Responses are usually pragmatic and designed for the problem, rather than predetermined. For example service concerns in retail banking were not dealt with through legislation but by a state run competitor who would offer appropriate service. For

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<sup>206</sup> Commerce Act 1986 s 1

<sup>207</sup> Commerce Act 1986 s 1A.

electricity the government has taken a different approach. The Commission has large interventionist powers in order to provide what the market has not, an electricity supply without the regular threat of supply shortages.<sup>208</sup>

#### **D Influences on the State**

This is a major shift in underlying government policy after 15 years of major party support for the free market. Part of the reason for the shift will lie in the government being able to see the results of the liberalisation program here and overseas. Often events have undermined the basis of market liberalisation. Joseph Stiglitz, Chief Economist of the World Bank commented in the foreword to *The New Politics a Third Way for New Zealand*

“This caricature of successful development – a straight recipe of open markets, free trade, unfettered capital flows, and minimal government intervention, all in the service of GDP goals – has largely been discredited in the last several years. Its shortcomings have been dramatically underscored by the successful development of many countries that did not heed its tenets, and by the failure of many that did.”<sup>209</sup>

New Zealand’s approach was considered one of the most pure in the world. It was comparable only to those countries that were forced to reform by the International Monetary Fund. This change in perception of the reforms highlights one of the major problems in Douglas’ approach to policy. If the results of reforms are meant to be the basis of their future acceptance, what happens if these results are unfavorable?

New Zealand’s own experience was to show examples of the liberalisation process not achieving its desired results. The government has had invest money in Air New Zealand and the Bank of New Zealand<sup>210</sup> and is currently negotiating a deal to buy

<sup>208</sup> Shortages have been predicted in other years apart from 1992, 2001 and 2003. See *Heat on for Politicians as Another Power Crisis Looms* (1994), *Dry-year Electricity Crisis Predicated* (1995), *Power Shortages Feared As Lake Levels Drop* (1997). These are all contained in Dennis Welch “Power Without Responsibility” (April 19-25 2003) *The Listener*.

<sup>209</sup> Chatterjee, S. (Srikanta) *The New Politics, a Third Way for New Zealand*. (Dunmoore Press, Palmerton North, 1999) Foreword.

<sup>210</sup> “From the Ashes” (5 October 2001) *The Press*.

a financially insolvent Tranz Rail.<sup>211</sup> These are all former national assets that are central to New Zealand's economy that were left to the free market and would have failed without government support. Tranz Rail in particular seems to have been the victim of the market. New Zealand Rail was sold in 1993 for \$328.3 Million. The company had \$322 Millions dollars of equity immediately removed before being publicly floated. The original major shareholders Fay Richwhite and Wisconsin Central did very well out of the deal. Fay Richwhite quit the company just over a year ago for an \$87 million dollar profit on their original \$31 million dollar investment. Wisconsin quit two weeks later netting a \$100 million dollar profit on its \$37 million dollar investment. Tranz Rail's lack of funds has led it to cut corners, resulting in last summers line buckling disrupting services. The original shareholders found that the shares they had paid over \$6 dollars for were now worth under \$1.<sup>212</sup> The deal has cost both the New Zealand public and the government close to half a billion dollars and has left New Zealand's rail system in desperate need of infrastructure investment. Electricity, as shown, has also had its share of problems that have been at least influenced by the free market. The New Zealand experience in electricity is not unique; the Californian electricity crisis in 2001 was a prime example of a de-regulated electricity system not working.<sup>213</sup>

On the other hand the government has also seen the positive aspects of the liberalisation of the economy, New Zealand now has continued growth, which was not the case in 1984, and many privatised industries now operate well. In telecommunications competition has lead to very cheap toll charges compared to pre-privatisation. The results of liberalisation have been mixed, often it has provided large benefits, in other cases there are the horror stories like those outlined above. It is unsurprising that the current approach seems to be on a case-by-case basis. Given the recent experiences with the electricity industry it is also unsurprising that it receives more direct intervention than others.

<sup>211</sup> Gareth Morgan "Govt Ventures Too High- Cost" (21 June 2003) *The Waikato Times* 23.

<sup>212</sup> Simon Louisson *Has Tranz Rail Derailed Itself?* (19 April 2003) *Hawkes Bay Today*.

<sup>213</sup> Haas School of Business, University of Berkley "Manifesto on Californian Electricity Crisis" see [http://www.haas.berkeley.edu/news/california\\_electricity\\_crisis.html](http://www.haas.berkeley.edu/news/california_electricity_crisis.html) last accessed 27 September 2003.

The political climate at present will also have had an influence. As New Zealand politicians have got use to MMP it has run much more smoothly. The house has divided itself firmly into left and right parts. This would cause the center-left Labour party to move somewhat left to gain support of minority parties. This tend's to favour state intervention in the market. MMP certainly seems to have stopped one party from holding absolute power and thereby reduced the chance of "Blitzkrieg" reforms happening again. Perhaps most importantly, the "Blitzkrieg" and the free market reforms have added to a swing away from that era's policies by many current politicians. Just as support for free market reform was aided by a rejection of Muldoon's unsuccessful use of ad hoc inventionalism, the current reforms swing away from the previous governments unwavering belief in the free market and the problems associated with that. The current response rejects the basis of both former policies, the government does not believe it can "beat the market" in most case's and it does not accept that the free market can always provide the best result's.

#### V CONCLUSION

The state's role in regards to the electricity industry has gone through three major policy shifts. The first and by far the longest had the government as effectively the sole generator and supplier of electricity to the New Zealand market. The state was heavily involved in the day-to-day operation of every aspect of the industry. This system eventually became grossly inefficient with huge mistakes made when making investment decisions under the "Think Big" projects. These decisions, along with state decisions in other industries, created a knee jerk response to the other extreme. Heavy-handed government intervention had failed. Its failure, and failure of the New Zealand economy generally, convinced Treasury and respective Ministers of Finance that the free market was the best form of regulation for almost any industry in New Zealand. For the electricity industry this mean a 15-year period of constant de-regulation, corporatisation, fragmentation and privatisation. By the 1999 the industry was unrecognisable from the beginning of the period. The election of the Labour lead coalition stopped this process. Its approach has rejected any one philosophy as being correct at all times. It has shown that

where the circumstances fit it will either leave the free market or use state regulation. What this means for the industry is unclear, but almost certainly it will include the government taking a bigger leadership role in the industry.<sup>214</sup> What other measures are taken will depend on whether electricity can run efficiently or whether there are repeats of the problems of the last 15 years. If the industry runs well, it will be left to operate, if it continues to cause problems it will face a pragmatic response by the government.

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<sup>214</sup> There are still many pressing issues in the industry, the two that are likely to be looked at will be New Zealand's base capacity and Hydro-reliance.

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