

**Incentive Regulation and Implementation**  
**Total Factor Productivity**  
**ACCC**

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**Friday 9 May 2003**

# Introduction

- **Is TFP an effective incentive regulation mechanism?**
- **Network owners' perspective of the impacts of a TFP approach**

# What is effective regulation?

## Objective

- Protect the long term interests of consumers re:
  - Price
  - Quality
  - Reliability

The objective can be achieved by:

- Offering sufficient incentives to facilitate investment
- Transparent decisions that treat businesses equitably in relation to business and external circumstances

# Approaches

## Focus today on 2 approaches

- Current Building Block Revenue
- TFP methodology

# Building Block

- Based on specific business historic costs (bottom up)
- Regulator assumes (TFP) efficiency factor through benchmarks
- Projected revenue = Projected cost of service
- Efficiency carryover allows retention of outperformance in excess of TFP benchmark for 5 years
- While incentives exist they are weak

# TFP Approach

- Limited Australian experience
- Top down, decouples revenue from costs over time
- If implemented well, should be less intrusive and less costly
- Could there be winners and losers?
- Approach would need to ensure starting point took into account structural issues (eg Urban v Rural)
- Once under way, businesses should be able to improve efficiency at similar rates

# Will TFP be more resource intensive?

- Initially a large body of data will be required:
  - verification
  - standardisation of data from differing sources
  - trend periods
- Once data set and methodology is agreed the process should be less intensive
- Will allow businesses and regulators to focus on outputs rather than inputs

# How will TFP deliver incentives for service standards?

- A mechanism would need to be developed
- ESC has already developed such a mechanism
- Should be possible to transfer that logic to any alternate methodology



# Incentivise investment

- TFP offers in-built benefit sharing mechanism
- Customers benefit as they receive efficiency and service improvements in line with a broad industry measure
- Stricter incentives on businesses are in place because revenue is decoupled from costs

# Prices need to take account of...

- Victorian businesses have been through 2 building block price reviews and significant efficiencies have already been delivered
- Differences between businesses (eg urban/rural)
- Need to allow for the impact of one offs (FRC, changes in regulations, etc)

# Conclusion

- There are options
- We need to move carefully and assess the options
- The key is that we encourage investment, innovation and service improvement
- TFP is a model worthy of investigation and if implemented well could deliver:
  - lower cost regulatory regime
  - improved incentive properties
  - more reliable efficiency gains for customers
  - a better outcome for customers