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SUBMISSION

Australian Senate

Economics References Committee

Inquiry into the Privatisation of State and Territory Assets and New Infrastructure

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Executive Summary

The Electrical Trades Union (ETU) is the Electrical, Energy and Services Division of the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (CEPU). The ETU represents approximately 65,000 workers electrical and electronics workers across the country and the CEPU as a whole represents approximately 100 000 workers nationally, making us one of the largest trade unions in Australia.

The Electrical Trades Union of Australia welcomes the opportunity to participate in the Senate Economics References Committee inquiry into the privatisation of state and territory assets and new infrastructure. State owned electricity networks are one of the prime assets owned by the taxpayers of state governments that are targeted by the Governments proposed 'Asset Recycling' program under the COAG National Partnership Agreement (NPA) on 'Asset Recycling' and the Asset Recycling Fund Bill 2014.

We use the term 'asset recycling' only in specific reference to the title of the NPA and the bill. In our view the title is deliberately misleading because the primary purpose of the fund is not to recycle state owned assets, but rather to facilitate their sale and privatisation via commonwealth financial inducements.

As Committee Members are no doubt aware, a majority of the federal Senate seemed to concur with that view when it voted earlier this year in July to amend the title of the Asset Recycling Fund Bill 2014 to include the words "encouraging privatisation" to its title.

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To be clear, asset recycling is simply another term for privatisation of state assets.

Public opinion on privatisation, or 'asset recycling' is crystal clear. Numerous polls across several jurisdictions in the last 18 months have all been overwhelming against privatisation of public essential services, and explicitly electricity networks.

The most recent and compelling evidence of this is result of the 2015 Queensland general election, where the Liberal National Party government sought a mandate from voters to privatise electricity, rail and port assets to fund new infrastructure projects through their 'Strong Choices' plan, and suffered a 12% swing on average across the state against their policies and were thrown out of office in just a single term.

The Queensland election was a referendum on asset sales and clearly voters rejected it. This should be of utmost importance to politicians elected to public office whose ultimate duty is to the voters who elect them.

The energy industry is unique as compared to industries such as roads, rail and ports because under the market laws and rules, approximately 70% of the capital cost of investment in transmission and distribution infrastructure is recoverable via the allowable pass on cost to consumers via determined revenue allowances.

In the case of electricity networks, much has been made of network costs as the main culprit of steep increases to residential electricity prices. In particular, the term 'gold plated' networks was coined in reference to publically owned transmission and distribution network businesses that (allegedly) overinvested in network capital

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expenditure in comparison to private networks. This has led to a barrage of calls from various industry sectors that those remaining public electricity networks, such as those in Queensland and New South Wales, should be privatised.

We do not agree that privatisation of the energy sector is the best way forward, not least of which is because privatisation does not lead to lower retail energy prices. In fact, the energy sector policies that delivered hyper-inflation of consumer electricity prices were largely a result of national competition based reforms that trumpeted privatisation. Advocates for privatisation of government owned energy infrastructure on the basis that it will driving increased market competition that will eventually be of benefit to consumers.

Continuing to pursue this failed and outdated ideology by linking it to funding future infrastructure is not warranted, impractical and disingenuous.

We are totally opposed to schemes for asset recycling as set out in the Asset Recycling Fund Bill 2014 and the National Partnership Agreement on Asset Recycling. Arrangements such as these are simply designed to induce states into privatising their public asset infrastructure, particularly energy infrastructure such as generators and networks.

In our view, commonwealth infrastructure funds for state governments should not be conditional on privatisation and be open to all large public infrastructure projects to allow new infrastructure projects to be assessed on their own merits without tying them to a federal ‘privatisation bribery’ payment. This is particularly true for essential services that form natural monopolies such as electricity, water, health and emergency services.

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Statements in Response to Terms of Reference Items

A. *The role of the Commonwealth in working with states and territories to fund nation-building infrastructure.*

As the recipient of taxation and Goods and Services Tax funds the Commonwealth has a critical responsibility on behalf of taxpayers to work with state and territory governments to ensure that taxpayer money is appropriately invested in new infrastructure that delivers meaningful value.

Commonwealth infrastructure funds for state governments should not be conditional on privatisation and be open to all large public infrastructure projects to allow new infrastructure projects to be assessed on their own merits without tying them to a federal 'privatisation bribery' payment.

B. *The appropriateness of the Commonwealth providing funding and the capacity of the Commonwealth to contribute an additional 15 per cent, or alternative amounts, of reinvested sale proceeds.*

Asset divestment decisions should be separate to new asset investment decisions.

The Productivity Commission raised concerns about linking asset sale and reinvestment decisions in its Public Infrastructure Inquiry Report of July 2014, stating:

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"On balance the Commission considers that decisions to privatise a state-owned asset and procure new infrastructure should be separate in time and space. The policy is risky because it may bypass thorough and transparent analysis."

C. *The economics of incentives to privatise assets.*

In the case of revenue generating assets such as electricity networks, it does not make economic sense to forgo a long term income stream for a one-off short term payment.

The aforementioned Productivity Report also stated:

"Governments should avoid creating the expectations in the community that privatisation is only good when the proceeds are used for procuring new infrastructure, as this might constrain future governments from optimising their balance sheets in the public interest."

The proposed asset lease of electricity networks in Queensland is a case in point.

Although the proceeds from long-term lease of the electricity asset was expected to raise over $30bn, the electricity Government Owned Corporations (GOCs) are highly geared and carry nearly $17bn in debt. According to the latest GOC audited financial statements, the Queensland Government's net equity in these GOC's is only around $11.5bn.

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The "Strong Choices' plan proposes to pay down $25bn of Queensland Government debt, however, only $7.6bn would be available to redeem budget sector debt. This is likely to save the annual Queensland Government budget around $400m per year. Offsetting this will be the loss of dividends, tax equivalents and competitive neutrality payments.

If the electricity GOC's are to be privatised through the offering of long-term leases the Governments would no longer receive tax equivalent payments, dividends or competitive neutrality fees from the GOC's. In such a scenario the Government can expect a one-off lump sum payment to compensate for the value of the leased assets.

In the case of Queensland electricity GOCs, according to our calculations (based on current government budget papers, GOC annual reports and regulatory data) under continued public ownership, the Government is estimated to receive around $100bn in revenues from the electricity GOC's after the first 50 years from 2014-15. In contrast, the asset privatisation that was proposed would only provide $54.1bn in one-off lease proceeds and interest savings over the same 50 years.

Extending the time horizon to 99 years, the difference between the financial results is even more profound. Normal operation would bring approximately $200bn. By comparison, a 99-year asset lease would bring $73.6bn in net revenue to the Government.

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D. *Safeguards necessary to ensure any privatisations were in the interests of the state or territory, the Commonwealth and the public.*

Legislative protections, such as referendum requirements, should be encouraged in those states where essential service assets are still publically owned.

For non-essential service assets each proposal should be subject to public cost benefit analysis and community education and engagement processes.

E. *Parliamentary scrutiny and the process for evaluating potential projects and for making recommendations about grants payments, including the application of cost-benefit analyses and measurement of productivity and other benefits.*

Privatisation, or asset recycling, of revenue generating essential services is not acceptable under any circumstances. Legislative protections, such as referendum requirements, should be encouraged in those states where these types of assets are still publically owned.

With regards to instances where non-essential assets are under consideration for privatisation through asset recycling there absolutely must be parliamentary scrutiny at both a state and federal level.

All proposals should be, at least, subject to full cost benefit analysis. Such analysis should not only take into consideration the economic impacts of the proposal but also social and environmental impacts.

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F. *Alternative mechanisms for funding infrastructure development in states and territories.*

In the case of revenue generating assets such as electricity networks, it makes greater economic sense to re-invest all, or part, of the revenue generated into new infrastructure projects which over the long term will provide a larger pool of funds to deliver infrastructure projects.

G. *Equity impacts between states and territories arising from Commonwealth incentives for future asset sales.*

Asset Recycling breaches fundamental equity principles because changes the determinate factor in what attracts commonwealth funding for future infrastructure from a projects own merits to what current assets can be sold.

Not all states have equitable assets. Clearly states that have already sold all, or part, of their major assets are not in an equal position to those that have not under the scheme.

The Energy Sector and Privatisation

Privatisation is often justified that it will create greater efficiencies through competition and lead to lower consumer prices and greater choice. However, the ETU rejects these assertions completely.

Privatisation of state of territory electricity assets such as power generators, high voltage transmission line and distribution lines are not in the short or long term economic interests of Australia and will have a detrimental effect on service standards and higher prices. It also means that reliable, universal electric services at a reasonable rate are replaced by a 'consumer choice' of a narrow supply of retailers that all essentially deliver the same product.

There are good reasons for government owned and operated services and enterprises, particularly those that are essential services. Government is not hampered by having to make a return to shareholders as a priority. Government is more likely to better look after the needs of consumers in remote areas as the less profitable areas of the business can be cross subsidised by the more profitable areas in higher population areas. Once Government sells its stake in the business, its ability to influence outcomes in the public interest is severely reduced as is its capacity to regulate market behaviour.

Privatisation as energy policy in government goes far beyond that of misplaced confidence in a particular ideology, there are numerous independent reports that have analysed privatisation parts of Australia's energy sector and shown that in almost every case it has failed to deliver on its promises and led to worse economic and social outcomes compared to public ownership.

In 2013 prominent Australian economist Professor John Quiggan examined of twenty years of electricity privatisation reform concluding that it has failed to deliver promised benefits for consumers. The independent report, "Electricity Privatisation in Australia: A Record of Failure", found that fiscal analysis did not support claims that there were any long-term benefits to governments or consumers from the sale (or lease) of energy assets.

Professor Quiggan's research examined the impact of changes since the 1990s based on free market and competition economic theories. The analysis found that, after a marked fall in real electricity prices across Australia from the 1950s until the mid-1990s, privatisation and the introduction of a National Electricity Market (NEM) led to a reversal in that trend. The research also revealed that:

- Price rises have been highest in States with privatised electricity networks;
- Customer dissatisfaction jumped, with complaints to the energy ombudsman in privatised States leaping from 500 per year to over 50,000;
- Resources have been diverted away from operational functions to management and marketing, resulting in higher costs and poorer service;
- Reliability has declined across a wide range of measures in privatised Victoria;
- promised increases to investment efficiency have not occurred;
- real labour productivity has reduced as employment and training of tradespeople was gutted and numbers of managerial and sales staff exploded;
- Private owners are receiving unjustifiably high rates of return based on the low investment risk; and
- Customer bills in privatised states include the cost of almost 10 per cent per annum interest on the corporate owners' debt, compared to government borrowing costs of close to three per cent.

Privatisation, corporatisation and the creation of electricity markets were supposed to give consumers lower prices and more choice, promote efficiency and reliability, and drive better investment decisions but after twenty years the evidence is that none of these promises improvements have been delivered.

Prices have risen dramatically, with the removal of the secure low-cost supply consumers previously enjoyed, and its replacement with a bewildering array of offers, all at costs inflated by a huge expansion in marketing.

Privatisation has produced no benefits to consumers, but has resulted in large financial losses to the public. It is time to admit that the NEM reform process, as a whole, has been a failure.

One of the main arguments for electricity privatisation, apart from the ubiquitous ‘greater competition drives greater efficiency and delivers consumer benefits’, is that privately-owned companies will have a stronger incentive to beat their forecast Opex and capex over a particular regulatory period, and hence operate more efficiently. Revenue is determined for a regulatory period by the Australian Energy Regulator (AER) for transmission and distribution networks (T&D) based on forecasts – if costs do not meet these forecasts, the firm will reap the difference as profit. It is, however, unclear why the same management principles would not apply to a publicly-owned firm. Even if a firm is publicly-owned, it still has a shareholder – the government – with efficiencies incentivised through the potential of stronger dividends for the budget.

It’s also worth noting that in the last regulatory period, NSW outperformed its capex forecasts by $3.7B – that is, over 20%. The evidence suggests that this ‘beating forecasts’ argument is weak and not compelling. The theoretical argument for privately-held T&D companies operating more efficiently than publicly held

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ones are not compelling or demonstrable.

While New South Wales, Queensland and Tasmania all have publicly owned T&D networks, Victoria and South Australia are privatised. In principle, one can therefore compare the relative cost-efficiency of networks in across the states and draw conclusions accordingly. After taking into consideration state-specific costs and the role of the physical span of the network, there is no compelling evidence that privately-held distribution companies outperform on opex per customer.

The independent McKell Institute released a report titled "Nothing to gain, plenty to lose" earlier in December 2014 that examined the likely implications of electricity privatisation in the NSW energy sector as part of the broader economic and infrastructure policy agenda of the current NSW Government.

Proponents of privatisation of NSW's Transmission and Distribution networks argue that it will improve efficiency and reduce prices. However the "Nothing to gain, plenty to lose" report found that this is not the case. Most of these previous studies on the have failed to properly account for factors that are largely beyond the control of network operators, including the physical span of the networks themselves, or other state-specific factors including state based taxes and regulations. Once these factors are appropriately accounted for, it becomes clear that public companies operate just as efficiently, and in some cases more efficiently, than their private counterparts.

"Most concerning are the higher overhead costs associated with privatised network businesses in Victoria, including spending on administration, marketing, advertising, and executive remuneration. Our report found no evidence to suggest that power prices would decline under private ownership. Instead, prices may be marginally higher as a result.

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Privatising NSW's Transmission and Distribution assets is likely to drive up prices due to higher overheads in comparable privatised businesses.

Benchmarking overheads against AusNet, the privately-owned Victorian Distribution company – which was deemed to be the most comparable privately-owned company based on physical span and the distribution of customers across city and rural areas – the report found that prices are likely to rise under privatisation. This directly contradicts recent arguments that suggest that privatisation will lead to lower prices. Overheads are not only higher at the privately operated AusNet, they are also growing at a faster rate. Privatisation is likely to bring NSW overhead costs more into line with those witnessed at AusNet. It is expected that increased overheads would cost the average household $38 more in the first year of operation. When the faster rate of growth in these overhead costs is taken into account, the additional overhead cost per annum increases to around $103 a year within just 5 years.

When taken together, this report calculated that the average NSW customer is likely to end up paying nearly $350 more due to higher overhead costs resulting from privatisation."

In its 2013 paper titled *'Electricity and Privatisation – what happened to the Promises?'* the Australia Institute[1] found that:

"The advocates of electricity reforms in the 1990s and since have argued for privatisation, corporatisation and competition with the promise of a more efficient industry and lower costs. The pervasive nature of this advocacy suggests there should be some solid evidence by now, especially with two decades of experience of

[1] Richardson, D, *Electricity and Privatisation – What happened to the promises?*, Technical Brief 22, The Australia Institute, Canberra, Australia, 2013, p11.

these 'reforms' behind us. Despite the promise of lower prices and a more efficient industry, electricity prices instead have been a major cause for concern on the part of Australian consumers. Over the period since March 1995 electricity prices have outpaced the CPI with an increase of 170 per cent compared with an increase of 60 per cent for the CPI."

Further to failing to deliver on one of the most critically important consumer outcomes, a 2012 report into electricity privatisation in Australia by Dr Philip Toner[2] found that:

"The global and Australian experience of privatised electricity markets is not a textbook model of competition, instead, there is an oligopolistic market dominated by 2-4 principal regional players, each exercising considerable market power.

Households are in no position to bargain with oligopolistic suppliers. Moreover, as occurs in many other highly concentrated industries such as insurance, financial services and telecommunications, offers to consumers from suppliers are difficult to compare and intended to obfuscate."

These excerpts represent key highlights of a larger body of evidence that clearly and rationally demonstrates that privatisation of energy is not in consumers interest. Essentially the question of public ownership comes down to whether or not the supply of energy should be part of the core business of government, and given how essential it is to daily life in Australia for communities and businesses alike, the answer is a resounding 'yes'.

[2] Toner, P, *Electricity in Australia – A Briefing Note*, Department of Political Economy, University of Sydney, Australia, 2012, p3.

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One of the fundamental tenants of privatisation is that it will deliver increased competition through which consumers will benefit with more choice. What we find in sectors like energy that are a natural monopoly is that after privatisation, through mergers, acquisitions and vertical integration, there exists a few keys private entities that control the sector.

AGL a dominant supplier of electricity and gas throughout Easter Australia retail market said in 2002 “We want to be one of what we predict will be three or four national energy players.” and this is basically what has happened. As an example, AGL, Origin and TRU dominate the Victorian electricity and gas markets, control almost all the electricity and gas markets in SA, QLD and ACT and AGL dominates the NSW gas market.

Governments have historically pursued competition policy and tried to create more competitive energy markets by separating generation, transmission, distribution and retail supply of electricity and either selling off or corporatizing the smaller units, barriers to new retailers or generators were reduced. Ironically this has simply led to public oligopolies being replaced by private ones.

What is of concern for the Committee, in our view, is that the government New South Wales, and the former government in Queensland deliberately try to misrepresent and obfuscate the facts around their electricity privatisation agenda. They expect taxpayers to vote on the proposals at elections without having the full facts at their disposal and are happy to spend tens of millions of taxpayer dollars on advertising and business advisory services in the meantime.

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Electricity Networks

In recent years much has been made of network costs as the main culprit of steep increases to residential electricity prices. In particular the term 'gold plated' networks was coined in reference to publically owned transmission and distribution network businesses that, allegedly, overinvested in network capital expenditure in comparison to private networks.

A report[3] currently being used by the NSW Government to support its push for privatisation has argued that the component of prices attributable to the network businesses is lower in Victoria than in NSW, and suggests that Victorian network prices are lower today (after excluding inflation) than they were in 1996.

However there are a number of issues that belie the fact that it is not a like-for-like analysis. The NSW Government report excludes smart metering (Advanced Metering Infrastructure 'AMI") costs in Victoria. Therefore, metering costs should also have been excluded from network costs in NSW, or AMI costs included in Victoria. They weren't. The analysis failed to ensure an adjusted comparison of the costs associated with different entities in different states. This is an important factor that is highlighted by the recent AER determination on Victorian AMI charges, which is examined in further detail later in the submission.

Also, the period of time used for the comparison carried substantial implications because network costs in Victoria began at a much higher base for the initial year of analysis, whereas NSW was achieving substantially lower network costs in 1996.

Contrary to allegations that privatisation has led to increased efficiency in network costs, what the data actually shows is that between 1996 and roughly the start of the

[3] Ernst & Young (2014), 'Electricity network services: Long-term trends in prices and costs'.

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last regulatory control period (2009), there was a convergence in network prices between the states.

Lastly, there is no attempt to take into account the physical span of the transmission and distribution networks in state owned jurisdictions such as New South Wales (NSW) and Queensland (QLD). This is a significant flaw in network cost comparisons. All else being equal, one would expect that the costs of NSW and QLD networks would be higher than Victoria's due to the greater difficulty in maintaining a geographically dispersed network as well as the sheer cost of building longer lines and more substations.

We believe that the current debate that focusses solely on network costs misses that big picture, which is what consumers are paying for their electricity.

While we acknowledge that network costs are a significant portion of the overall cost of electricity, the only true consumer measure is retail price. So suggestions that network costs are more efficient in a privatised jurisdiction like Victoria compared to those in NSW or QLD, when the actual retail price is equal to or higher (South Australia) are disingenuous.

Conclusion

Overall is can be clearly demonstrated that privatising energy networks in particular, in order to fund infrastructure requirements:

Does not make economic sense;

Is not and electorally acceptable policy; and

Does not deliver positive market outcomes for consumers.

Further to these fundamentals, the mechanisms proposed by the current Government are inequitable and impractical.

We urge the Committee to arrive at these same conclusions in its final inquiry report.

Appearance as a Witness

The ETU is willing and available to appear as a witness and would welcome an invitation to appear before the Committee if and when it conducts public hearings.

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