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HD **Baird on a wire**

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Privatising public assests is a risky business, write Sean Nicholls and Brian Robins.

Nine months from his government's first re-election test, Mike Baird has taken the biggest gamble of his short political career.

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Well aware that opinion polls have consistently shown significant sections of the electorate are vehemently opposed to privatisation of the NSW electricity network, this week the Premier announced a plan to do precisely that - or at least 49 per cent on a long-term lease.

NSW political history is littered with the failures of other leaders to achieve the same. But the Baird calculation is voters will be swayed by his pledge of an ambitious roads and rail spending program to fix the state's dysfunctional transport infrastructure funded by an estimated $20 **billion** in revenue.

"Many have tried and many have failed," the Premier said on Tuesday. "If it comes with political risk I say, bring that risk. Because fighting for what is right for the people of NSW, well that's my job."

The statement acknowledged just how big a boost the decision is to the Labor opposition and its chances at the 2015 poll.

For Labor, the weapon of choice is electricity prices and their long history of being exploited for political gain in NSW.

A decade ago, the residents of South Australia experienced the nastiest kind of collective electric shock. A few years earlier, in 1999, John Olsen's Liberal government had taken the privatisation plunge and sold the state's electricity assets.

Four years later, the state's retail electricity market was deregulated after household electricity bills soared almost 24 per cent.

Today, South Australians are burdened with among the highest electricity bills on earth, ranked only behind Germany and Denmark according to a 2012 report.

The average annual South Australian bill is now $2335, compared with $1960 in NSW and Victoria, figures from the Australian **Energy** Regulator (AER) showed in February.

The gulf was seized upon by NSW Opposition Leader John Robertson this week in an attempt to trash the Baird government's announcement that it would take the proposal to lease 49 per cent of the state's electricity network to private operators for 99 years to next year's election.

"The public know that any private operator will want to make a big profit from the **billions** they will spend to buy our electricity network," he warned. "That means families will pay for those profits."

Baird responded with a Treasury-commissioned report by Ernst and Young tracking the movement of network electricity prices in South Australia and Victoria (where they have been privatised) with NSW and Queensland (where they have not).

The report showed that under government ownership prices have more than doubled while in private hands they have fallen modestly.

(The report also noted a contributing factor was the investment that had been pumped into NSW and Queensland in recent years to upgrade an ageing network, and that Victoria and South Australia were due to follow suit.)

But no amount of consultants' reports is likely to fully neutralise the campaign already building from the opposition and electricity unions against the sell-off.

Baird has grasped the nettle despite recent history being littered with the failures of other state leaders to convince a deeply sceptical electorate. Opinion polls consistently show strong resistance to the idea.

So what should Sydneysiders believe? Should we be preparing - if Baird receives his election mandate - for animated family debates before the air-conditioning is switched on in summer?

Or should we trust assurances from the government, which says network businesses will perform far more efficiently in private hands (thus keeping prices low) and revel in the infrastructure promises attached to the anticipated $20 **billion** proceeds?

According to some who have studied the question of power privatisation for decades, the answer is: neither.

The bad news is that while NSW is unlikely to experience bill shock of the South Australian variety, it is the electricity consumer who always seems to be the loser, no matter the ownership model - private or public.

For many, the culprit is the system under which electricity prices have been regulated in NSW and later nationally; a system that has its genesis in a catastrophic event in New Zealand. In 1998, Auckland, New Zealand's largest and most important city, suffered a devastating power failure that lasted 10 weeks.

More than 700,000 people were affected, with more than half the city's businesses forced to evacuate the city centre to keep trading. The economic loss felt throughout all sectors of the economy was immeasurable, quite apart from the reputational damage to the city.

To avoid Sydney suffering the same fate of a prolonged power outage, the NSW government moved to ensure the state's economic heartland - Sydney's central business district, along with the Hunter Valley's coalmines and aluminium smelters - would have back-up supplies in the case of blackouts.

The aim was to put the CBD and the Hunter on a par with other global cities such as New York, London, Tokyo and Chicago. But it came at a cost.

The push for improved service reliability along with the need to replace a slew of aged equipment set the scene for surging spending, which has rivalled the cost of the $30 **billion** national broadband network.

Perhaps unsurprisingly, the network companies have been roundly criticised for "**gold** plating" the power network due to the massive spending program, which had Ausgrid alone spending more than $1.5 **billion** annually for several years over the past decade.

From the late 1990s, electricity prices were controlled by the Independent Regulatory and Pricing Authority (IPART), which the industry claimed artificially held down prices.

"There was significant under-investment because previous regulatory regimes were overly focused on price outcomes," George Maltabarow, former managing director of Ausgrid, the largest distributor in NSW, told a public forum in late 2011.

When the regulation of the industry's spending plans passed a few years back from IPART to the AER, the new body was effectively a toothless tiger since it could not reject spending proposals put forward by power companies.

Maltabarow told the 2011 conference the earlier under-investment under IPART meant network companies were "having to catch up and invest now, which means consumers are paying for it all in one hit".

The catch-up phase has resulted in power prices doubling in NSW over the past five years, prompting a public backlash that forced politicians to act.

The regulator has now been given the power to force networks to cut unnecessary spending.

After years of big spending, the AER recently rebuked NSW government transmission **company**Transgrid for inflated spending plans, for example, forcing it to cut prices by 2.3 per cent rather than raise them by the planned 7.3 per cent.

Similarly, Ausgrid has been forced to cut its proposed capital spending by about 10 per cent. "The regulator does have more teeth," Gavin Dufty, a policy officer with the St Vincent de Paul Society, says. "It does have the powers now to push back on spending proposals."

Additionally, the network companies must now go through a community consultation process, which also includes the ability for planned spending to be opposed.

Just as important, the AER has been "skilled up", Dufty says.

When the AER initially had control over spending plans, it did not have sufficient in-house capability to challenge the spending proposals put forward by network companies. That has now changed, with the likes of Jim Cox, who formerly ran IPART, moving across to beef up the senior ranks of the AER, which is an arm of the Australian Competition and Consumer Commission.

Broadly, this means the companies proposed for privatisation by the Baird government - Ausgrid, Endeavour **Energy** and Transgrid (Essential has been exempted after a Nationals revolt) - now come under the new, stricter regulatory rules.

Potential bidders for the companies include the likes of Canada's big pension funds, which have already invested heavily in the state's ports and toll roads, and **China** State Grid, which paid $824 **million** last year for a fifth of SP Ausnet, which has electricity and gas networks in Victoria. Then there are local super funds as well as public investors such as Duet, Spark Infrastructure and SP Ausnet, which own Victoria's power network operators.

In theory, a shift from public to private ownership should have little or no bearing on the prices they can charge.

When deciding by how much Australia's electricity network companies can increase their prices every five years, the AER must treat them in exactly the same manner, regardless of their ownership.

The NSW government argues that it's the efficiency with which a network business is run that can change under private ownership.

Because the AER bases its determinations on what "efficient price" the network should be run at - while at the same time delivering a "commercial return" to the owners - in theory a privately owned **company** that found savings (including job cuts) could lower its prices.

"Privatisation of the network businesses is unlikely to have a huge effect on prices, because they are a regulated monopoly," John Quiggin, a laureate fellow in economics at the University of Queensland, says.

He says the finger should rather be pointed at the reform process, which has changed how electricity prices are regulated in Australia.

"Privatisation is part of the whole process of reform, which was supposed to drive down prices but in fact has pushed them up," he says.

"The really big increases have been a result of the reform process as a whole rather than privatisation, even though privatisation is part of the process".

In Quiggin's view, the formula followed by the AER puts consumers at a disadvantage as it gives "a return to capital which is too high".

This is demonstrated by the prices the private sector has been willing to pay for government businesses - an indication that the price increases they are being granted are well beyond what is needed to cover costs and upgrades.

"The people who pushed these reforms - the national electricity market and the trend towards corporatisation of government network businesses - assured us they would give us lower prices," Quiggin says. "That hasn't happened."

The main risk for privatising network businesses is that "over time the private operators can potentially drive a harder bargain" to secure price increases. "They've got more of an incentive as owners," he says. "If you're publicly owned, the state government on the one hand gets the money but on the other hand they bear the opprobrium of higher prices."

More broadly, Quiggin is critical of the "half-baked" aspect of Baird's proposal. A partial **sale** and lease "reduces the return to the public with no benefit".

Quiggin, who has researched the South Australian experience, says the main driver of the price spike the state encountered a decade ago was deregulation of the retail market.

Mark Henley, a member of the consumer advocacy panel within the AER, agrees with Quiggin that prices are unlikely to rise if the network businesses are transferred to the private sector. But neither does he believe prices will go down.

Like Quiggin, Henley believes the regulatory system is stacked in favour of the network businesses, no matter who owns them.

"The shareholder, whether government or private, is the winner," he says. "The loser, irrespective of government or private ownership, is consumers."

The "critical determinants" of the impact on customer prices from a privatisation are the conditions of **sale** and the regulatory environment, he believes.

This is where Henley - who is also the **energy** advocate with UnitingCare Australia - says the Baird government could do a lot more to protect consumers.

"Where's the **sale** condition that sets a limit on profits or prices consumers pay?" he asks.

The government has proposed writing into the lease contracts a condition that new owners must discount by 1 per cent any price rises granted by the AER.

"That's a bit cynical because they know that the bids from NSW **energy** companies are for a reduction in network prices over the next five-year regulatory period," Henley says.

The measure amounts to just $9 a year for the average NSW household from the estimated **sale** date of late 2016 until 2019. If the government is so confident about the price impact, it should task an independent reviewer such as IPART to provide "good accurate publicly available data on a regular basis", Henley says.

Robertson and the public sector unions are gearing up for a nine-month campaign on the issue, focused squarely on the claim that electricity prices will go through the roof.

As Prime Minister Tony Abbott showed during his past three years in opposition with his relentless attacks on the carbon tax, unswerving focus on a hot-button, hip-pocket issue can pay enormous electoral dividends.

Robertson is an experienced campaigner on the issue -as Unions NSW leader he blocked former premier Morris Iemma's push to get electricity privatisation through the Labor Party. How Baird responds is set to shape not only his political future but also that of the entire Coalition government.

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