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MEDIA RELEASE

31 October 2011

Professor Bob Walker and Dr Betty Con Walker today called on NSW Premier Barry O'Farrell to maintain his pre-election stance of opposing the sale of the State's highly profitable electricity assets.

Releasing a *Briefing Note* (attached), Prof Walker and Dr Con Walker said that Mr O'Farrell's own 2011-12 Budget reveals that the Government is expecting to receive some $6.5 billion in dividends and tax equivalents over the five years to 2014-15. The loss of these revenues would impact the forecast Budget results directly, leading to deficits in each year of the Coalition's first term of government if the funds are merely used to pay down debt or are invested in already subsidised rail infrastructure.

A sale would also deprive the Government from reaping the benefits from the significant capital investment made by the electricity agencies from their own resources over recent years – with some $19 billion spent over the seven years to 2010-11 – at no cost to the Budget.

Moreover, Prof Walker and Dr Con Walker noted that the negative impact of the part-privatisation of electricity assets has now been confirmed with the Budget Papers concluding that in the period to 2014-15, there will be a negative impact on the Budget result of $347 million.

Premier O'Farrell has no mandate to sell the State's electricity assets. More importantly, the unquestionable conclusion is that any further electricity privatisations would not be in the best financial (or other) interests of the State.

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BRIEFING NOTE

2011-12 NSW Budget Papers confirm that Electricity Privatisations have been bad deals

The NSW Budget Papers are presented in six volumes – plus a 'Budget Overview' – and it is no surprise that journalists and commentators working to meet deadlines don't always identify issues that are buried in the detail (especially when the Budget Overview focuses on the Government's chosen message of the day).

When the NSW Budget was brought down on 6 September 2011 neither Premier O'Farrell nor Treasurer Baird highlighted the fact that the part-privatisation of public electricity assets by the previous government has reduced the State's revenue base (even after the proceeds were re-invested in interest-bearing deposits).

It will be recalled that former Premier Iemma and former Treasurer Costa claimed that the State needed to invest up to $15 billion on infrastructure 'to keep the lights on' – and claimed this was not affordable. Our response was that investment at those levels was already being made, and was mainly funded by the electricity industry's operating cash flows. Moreover, further investments in electricity infrastructure would generate additional revenues.

The latest Budget Papers confirm those interpretations, and emphasise that past investments in infrastructure have already enhanced the profitability of the remaining electricity businesses.

1. Negative Budget impact of part-privatisation

On 14 December 2010, the previous NSW Government entered into the following transactions:

- the retailing arms of Country Energy and Integral Energy, along with the Generation Trading Agreement (Gentrader Agreement) for Eraring power station, were acquired by Origin Energy for an aggregate of $3,250 million;

- the retailing arm of Energy Australia, the Gentrader Agreement for Delta Electricity's Mt Piper and Wallerawang power stations, and development sites at Mt Piper and Marulan were acquired by TRUenergy for an aggregate of $2,035 million (*2011-12 Budget Paper No. 2*, p. 8-9).

The Bamarang power station development site was sold to Infatil for $9 million in February 2011.

No bids were received in a second round of bidding for Macquarie Generation's power stations and Delta Electricity's coastal power stations and these assets along with four power station development sites remain in Government hands (*ibid.*).

It will be recalled that there was a lack of clarity as to the financial costs and benefits of this part-privatisation to the State. The 2011-12 Budget outlines what it describes as 'the revised impact of the transactions on the Budget result over the period from 2010-11 to 2014-15'. It concludes that in the period to 2014-15, there will be ***a negative impact on the Budget result of $347 million***, as shown below.

Table 1

NSW Budget Results Impact of Part Privatisation of Electricity Assets

Budget Result Impact	2010-11	2011-12	2012-13	2013-14	2014-15	Total 2010-11 to 2014-15
	$m	$m	$m	$m	$m	$m
Reduction in Interest Expenses @ 6%	75	233	244	259	273	1,084
Loss of Financial Distribution and Government Guarantee Fees	(51)	(317)	(252)	(106)	(106)	(832)
Availability Liquidated Damages, Separation Costs and Other Costs	(61)	(4)	(174)	(138)	(224)	(600)
Budget Impact	**(37)**	**(88)**	**(181)**	**15**	**(57)**	**(347)**

Source: *2011-12 NSW Budget Paper No. 2,* p.8-10.

The last two lines in the Table show the loss of revenues to the general government sector arising from the privatisation transactions, totalling $1,432 million over five years. The first line reflects the consequences of another transaction – the returns supposedly to be received from re-investment of the proceeds to earn 6 per cent per annum (an earlier version of this Table showed expected returns at the rate of 8.6 per cent, and was given the misleading description of 'reduction in superannuation expenses').

Yet it will be recalled that when the Iemma and Keneally Governments proposed the sale of electricity assets they suggested that the funds would be reinvested in railways infrastructure (which doesn't make a profit for government – in fact, government subsidises around 70% of the operations of RailCorp). If this course of action is followed by the O'Farrell government, the current Budget result projections are overstated by close to $1 billion.

Further, other negative impacts of the part-privatisation on the State include the commitments related to the Cobbora Coal Mine which Budget Papers confirm 'have a negative net present value to the State of approximately $300 million' (p. 8-12).

2. Further sale of electricity assets will be costly

2.1 Remaining electricity assets

The electricity assets which remain in State ownership include:

- the transmission assets managed by TransGrid;
- the distribution assets managed by the rebranded Ausgrid, Essential Energy and Endeavour Energy;
- generation assets belonging to Eraring Energy and Delta Electricity (West) – but the energy output has been contracted to retailers under the gentrader model;
- the assets and rights to output of Macquarie Generation and Delta Electricity (Coast).

2.2 Electricity agencies' payments to the Budget

The remaining electricity businesses are supporting the Budget through dividends and tax equivalent payments (though arguably the O'Farrell Government is adopting the same strategy as prior Coalition Governments with escalating demands for dividends). Budget Papers show that **in the period 2010-11 to 2014-15, the State Budget will receive $6,531 million from electricity agencies.**

Table 2
Dividends and Tax Equivalent Payments from the Electricity Sector: Post Part-Privatisation

	2010-11 Est. Actual $m	2011-12 Budget $m	2012-13 Estimate $m	2013-14 Estimate $m	2014-15 Estimate $m	Total 2010-11 to 2014-15 $m
Dividends						
Generation	204	117	80	42	36	**479**
Distribution & Transmission	490	579	825	766	668	**3,328**
Income tax equivalents						
Generation	166	100	39	27	30	**362**
Distribution & Transmission	522	360	524	507	449	**2,362**
Total	**1,382**	**1,156**	**1,468**	**1,342**	**1,183**	**6,531**

Source: Based on data presented in *2011-12 Budget Paper No. 2*, p. 5-18.

2.3 Budget results if electricity assets sold

All other things remaining equal, if the remaining electricity agencies were to be sold, then the Budget results would be as follows.

Table 3

NSW Budget Results 2011-12 to 2014-15: With Loss of Electricity Revenues

	2009-10 Actual $m	2010-11 Est.Act. $m	2011-12 Budget $m	2012-13 Estimate $m	2013-14 Estimate $m	2014-15 Estimate $m
Budget result with Electricity revenues	989	1,264	(718)	292	156	152
Less Electricity revenues			1,156	1,468	1,342	1,183
Budget Result	**989**	**1,264**	**(1,874)**	**(1176)**	**(1,186)**	**(1,031)**

Source: Based on data presented in *2011-12 NSW Budget Paper No. 2,* p. 3-6.

This suggests that the State simply cannot afford to sell its remaining electricity assets.

Note that the above figures ignore the possibility of returns from re-investment of proceeds in other projects (though as noted above, some may not be revenue producing), or the financial effect of reducing borrowings. But, as shown in Table 1 above, any interest revenues are likely to be less than the returns that could be received by the Budget from dividends and tax equivalents. In any event, Table 1 only reflects the financial impact of privatisation on the general government sector, and ignores undistributed profits retained within electricity agencies to sustain on-going investment.

3. Electricity capital expenditure

Strong and stable cash flows from electricity operations have comfortably enabled capital expenditure in the electricity sector of some $19 billion over the seven years to 2010-11 as shown below.

Table 4

Capital Expenditure in the Electricity Sector: 2004-05 to 2010-11

	2004-05 $m	2005-06 $m	2006-07 $m	2007-08 $m	2008-09 $m	2009-10 $m	2010-11 $m	Total 2004-05 to 2010-11 $m
Total	**1,408**	**1,762**	**2,314**	**2,709**	**3,768**	**3,355**	**3,363**	**18,679**

Source: Various *Budget Papers*.

The State's taxpayers (not private sector purchasers) should be the beneficiaries of improved infrastructure resulting from such expenditure.

The 2011-12 Budget outlines a further increase in capital expenditure of about $17 billion in the four years to 2014-15 as shown below.

Table 6

Capital Expenditure in the Electricity Sector: 2004-05 to 2010-11

	2011-12 Budget $m	2012-13 Estimate $m	2013-14 Estimate $m	2014-15 Estimate $m	Total 2009-10 to 2013-14 $m
Total	**3,993**	**4,317**	**4,235**	**4,240**	**16,785**

Source: *2010-11 Budget Paper No. 2*, p. 8-8.

According to the Budget Papers, the key drivers for this capital expenditure are new customer connections, increasing summer peak demand and the replacement and renewal of assets that reach the end of their useful life' (p. 8-12). This expenditure is also expected to support the 'target for average electricity reliability of at least 99.98 per cent by 2016' (p. 8-13).

Plainly much of this expenditure will further enhance the revenue raising capacity of the public electricity sector in future years, and as the Budget Papers state:

> The capital expenditure of network businesses over the remaining three years of the regulatory period to 2013-14 will increase their regulatory asset base by around 40 per cent. As the asset base grows, earnings of the network businesses will increase because the regulated revenue includes a return on assets (p. 8-13).

Funding of any new capital expenditure is through 'a mix of operating surpluses and net debt' (p. 8-14) and has no impact on the Budget. The increase in gearing, following an increase in net debt, is described as:

> sustainable during this period of high network investment because the networks have a regulated revenue stream and the assets typically have long lives (*ibid.*).

Further, earnings from the businesses grow as the asset base grows. As noted in the Budget Papers:

> Earnings from the network businesses are forecast to rise over the period to 2013-14, largely because the capital expenditure allowed by the AER [Australian Energy Regulator] increases the regulatory asset base from which a large proportion of the regulated revenue is derived (*ibid.*).

4. Electricity privatisation is not in the public interest

Developments since the part-privatisation of the State's electricity assets have confirmed the folly of privatising such valuable and profitable assets.

- Sale of the electricity retailers only leads to a loss of revenue to the State and higher prices to consumers.
- New investment is likely to generate increased returns to the State.
- Selling highly profitable assets that provide basic services is not a 'reform' – it is foolish.
- Cash flows from the State's electricity businesses are relatively stable – in contrast to the volatility of the State's revenues from property taxes – and hence actually enhance the State's capacity to borrow for new investment in infrastructure.

The 2011-12 Budget has confirmed that retention of the profitable electricity assets is not only affordable but financially prudent.

The above observations include comments similar to those we provided to the *Special Commission of Inquiry into the Electricity Transactions* in a detailed submission of around 100 pages (including appendices).

We were surprised that the Commission has failed to act in a transparent manner. It did not make submissions available for public scrutiny, and it did not hold public hearings. Indeed, if we published our submission we would be in breach of directions of the Commissioner in terms of the *Special Commissions of Inquiry Act 1983* and be subject to financial penalties.

We were even more surprised by events when we were directed to appear before the Commission. Our submission addressed three of the Commission's Terms of Reference dealing with 'value for money achieved by the State compared to the retention value of the assets to the State', 'the costs and benefits to the State of the electricity transactions', and 'related matters'. But we were not asked a single question relating to our submission or those topics in general.

Naturally we look forward to seeing the Commission's final report – and Premier Barry O'Farrell's response to it. After all, Premier O'Farrell was elected following his opposition to the electricity privatisation proposals of the Keneally Government. He does not have a mandate for any further sales. More importantly, even though self-interested parties are urging the Premier to reverse his stance, ***further electricity privatisations would not be in the best financial (or other) interests of the State***.

October 2011