1. The NSW Business Chamber welcomes the opportunity to make a submission to the NSW Government’s Special Commission of Inquiry into Electricity Transactions. The NSW Business Chamber represents the interests of around 30,000 companies across NSW and the ACT, ranging from owner-operators to corporations and from manufacturers to service providers.

**Scope of our submission**

2. While the Special Commission of Inquiry is likely to focus on the circumstances surrounding the previous Government’s sale of electricity assets late in 2010, our submission deals largely with the final heading set out in the Inquiry’s Public Notice, namely “options for future action that could be undertaken to further the public interest in a competitive NSW electricity sector, including options to promote competitive electricity prices and ensure reliability of supply.”

**Electricity prices in NSW**

3. Electricity represents a considerable input cost for businesses of all sizes in NSW. In an increasingly global marketplace, Australia’s relatively low and stable electricity costs represent an important competitive advantage. Continuing price hikes and substantial increases in electricity pricing will significantly undermine this advantage.

4. Energy prices have escalated particularly rapidly since the middle of 2009, and this rapid price escalation is expected to continue until at least 2013. Energy prices will have almost doubled in real terms over the decade to 2012, and if a carbon price of $26 per tonne is introduced from 1 July 2012 (consistent with the Government’s earlier CPRS proposal), then prices will more than double, in real terms, over this period. Changes of this magnitude will have a significant impact on the sustainability of many Australian businesses.

5. While all Australian States have been struggling under the impact of rapidly escalating electricity prices, prices in NSW are increasing more quickly than in other jurisdictions. A decade ago, NSW had the lowest electricity prices of all Australian states, whereas today prices in NSW are the second highest in the country behind South Australia.1

**Factors contributing to electricity price increases**

6. The recent growth in electricity prices in NSW has been principally driven by two factors, escalating network costs and Government programs targeting reductions in carbon emissions. This is particularly apparent in the 2011/12 financial year, when electricity prices in NSW will increase by a further 17.3 per cent.2 Of this amount, more than half is due to increases in

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network costs, with most of the remainder due to changes made to the Federal Government’s Renewable Energy Target (RET).  

Network prices

Network prices will be responsible for the majority of the increase in electricity prices in NSW over coming years. IPART found that network costs alone would increase electricity prices by between 16 and 35 per cent over the three year period from 2010-11 to 2012-13.

There are a number of different factors contributing to the rapid escalation in network costs, both through shortcomings in the national regulatory framework, and inefficiencies stemming from the ownership arrangements surrounding the NSW network providers.

The regulatory framework

In April 2009, the AER released its final determination on distribution and transmission network fees for the period from 2009-10 to 2013-14. In December 2009, the NSW distribution and transmission service providers successfully appealed the AER’s determination, with the Tribunal finding that the AER made an error in calculating the bond rate to be used in determining the cost of capital.

The final result was that approved increases in network charges are significantly higher than CPI. In total, network charge increases will increase regulated electricity prices by 35 per cent for Country Energy customers, 31 per cent for Energy Australia customers and 16 per cent for Integral Energy customers, over the three year period of the current IPART determination.

The NSW Business Chamber recognises that investment in electricity infrastructure is essential to ensure that NSW continues to have a consistent and reliable electricity supply. Nonetheless, these increased network costs represent a dramatic increase in infrastructure expenditure – an increase which will be wholly passed on and borne by electricity users.

The AER stated that investment of this magnitude was necessary “to augment the networks to accommodate the growth in maximum demand for energy, to replace ageing assets and to improve network security and reliability.”

However, other independent assessments of electricity networks in NSW have suggested that investment of this magnitude may not have been necessary to ensure security of supply for NSW customers. For example, Garnaut’s recent research notes that while a large proportion of the increase in network expenditure in recent years has been driven by network upgrades to meet increases in peak demand and higher reliability standards, much of this expenditure has been unnecessary.

In relation to peak demand, Garnaut notes that, “other countries provide high incentives to reduce energy demand at the peaks, while Australian energy regulatory settings reward distributors for growth in peak demand.” This issue is discussed further in our submission in the demand management section.

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5 ibid.
8 ibid., p. 152.
13.2. In relation to reliability standards, Garnaut notes that, “The setting of reliability standards and service requirements has not been subject to institutional or regulatory reform. We already have a reliable system. It is important that disciplines are introduced that balance consumers’ interest in low prices with marginal improvements in reliability. This marginal increase in reliability comes at a cost that is paid by all electricity consumers, and not necessarily valued at anything like their cost by many of them. There is no opportunity for consumers to make their own choices on what they are prepared to pay for greater reliability, when standards are already high.”

14. While the Chamber agrees that a secure energy supply is essential for NSW businesses, security of supply should not be pursued at any cost, and an appropriate trade-off needs to be reached between the desires for a highly secure supply and a low cost of energy.

15. In addition to these concerns, it is difficult to assess the efficiency of the approved expenditure under the current AER review process. Objective measures of efficiency and productivity improvements are needed to demonstrate that the network providers are operating as efficiently as possible, and that the cost estimates are in line with estimates that would apply if the network providers were operating in a competitive environment.

16. We believe that benchmarking can play an important role in helping to ensure that network investment represents value for money. However, while the AER sees benchmarking as a useful tool, it nonetheless believes that its application “should be limited to a top down test of more detailed bottom up assessments.” We believe that such an approach does not go far enough.

17. In the absence of competitive benchmarking, the performance of network businesses cannot be properly assessed. Users need to be assured that network providers are increasing their efficiency and that there are programs in place for continuous productivity improvements. We agree with the concerns raised by the EUAA that “the AER’s decision not to apply benchmarks in its efficiency assessments is likely to be a significant factor limiting its ability to constrain inefficient expenditure.”

Recommendation 1: That the NSW Government pursue, (through participation in the Ministerial Council on Energy) reform of AER processes to place greater emphasis on benchmarking in future regulatory reviews.

Recommendation 2: That any further proposed increases in reliability standards be put through a transparent cost-benefit process to compare the benefits with the increased electricity prices that would flow from their implementation.

Demand management

18. The growth in peak demand is currently much higher than the growth in total annual energy consumption. Energy Australia, Integral Energy and Country Energy estimate annual growth in peak demand to be around 3 per cent per annum, while growth in total energy consumption is estimated at around 1.5 per cent per annum. The growing gap between peak energy demand and total energy demand is an important factor behind the high infrastructure investment programs approved by the AER.

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19. Demand management offers a possible alternative to further capital increases. Presently, demand management does not appear to be playing a large enough role in network providers plans to make a significant difference to peak demand. There is capacity for demand management to play a more significant role in deferring capital expenditure. In its November 2008 draft decision, the AER acknowledged the need for effective and reliable demand management as a tool to help manage peak demand. The challenge will be to translate this acknowledgement into outcomes for energy consumers. As growth in peak demand continues to outstrip overall demand growth, the need for more comprehensive demand management strategies will become more and more urgent.

Recommendation 3: That the AER review process provide greater incentives for network providers to implement demand management strategies.

Ownership of the NSW networks

20. In addition to the difficulties created by the regulatory framework, we believe that the current ownership arrangements for the networks in NSW lead to further inefficiencies. With the Government owning the regulated network providers, and taking dividends from their businesses, there is an incentive to see outcomes delivered which maximise the value of the business and the dividend stream. Unfortunately, these outcomes do not result in the efficient delivery of electricity to NSW users.

21. It is also arguable that privately owned companies are more focussed on delivering efficiency improvements than publicly owned companies. While private companies have a fundamental objective of maximising business profits, publicly owned companies may give greater weight to other non-financial considerations.

21.1. For example, wage costs appear to be higher in publicly owned networks. The Final Report of the NSW Electricity Network and Prices Inquiry from late 2010 found that the growth in wages paid by the Government owned networks has exceeded average wage growth in NSW since 2004-05, and that this “has been accompanied by significant growth in staff numbers” in these organisations.

22. The NSW Business Chamber is not alone in noting the improvements in operation that could be expected to flow from privatisation. In 2010, a report by Mountain and Littlechild compared the publicly owned network providers in NSW with private network providers in Victoria and the United Kingdom.

23. The report found that “costs and allowed revenues in NSW are now higher than in Great Britain and Victoria, and increasing at a significantly faster rate,” and that “…Great Britain and Victoria have managed to accommodate increasing demand and improved quality of service at broadly constant or even declining costs while delivering higher quality of service, while NSW has not.” While noting that this divergence in performance may be due to a range of factors, they nonetheless found that “an important part of the explanation seems to be private ownership in Great Britain and Victoria compared to state ownership in NSW.”

24. In addition, the Mountain-Littlechild paper noted that where a government derives revenue from the ownership of a regulated company it has an interest in the profitability of that company, and is therefore more likely to support regulatory frameworks that continue to provide this revenue stream than would otherwise be the case.

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13 Mountain & Littlechild, Comparing electricity distribution network revenues and costs in NSW, Great Britain & Victoria, Sep 2010.
25. Garnaut’s research has also noted the difficulties presented by Government ownership, finding that “State Government owners have an incentive to overinvest because of their low cost of borrowing and tax allowance arrangements. In addition, political concerns about reliability of the network, and about the ramifications of any failures, reinforce these incentives.”

26. The NSW Business Chamber has been an active supporter of power privatisation because of the compelling benefits it offers NSW taxpayers. However, we do not support privatisation at any price, nor privatisation where the financial return to the people of NSW is not maximised.

26.1. In relation to the recently completed Gentrader sale in particular, we expressed concerns about the process as early as November 2009, noting that: “the model being presented to the market place appears to be flawed and will ultimately result in NSW being underpaid for a very valuable asset,” and that “...the ‘gentrader model’ being pushed by the Government will not get NSW taxpayers the best financial outcome. Nor will it increase competition within the retail or wholesale markets, nor is there any indication it will ensure more reliable supply.”

26.2. We again called on the NSW Government to abandon the sale process in December 2010, stating that: “Business is a long term supporter of electricity privatisation, but frankly we are not a supporter of a privatisation process that undervalues NSW assets and ensnares NSW businesses in a Gen-Trader system which will, over time, hinder competition and drive up electricity prices.”

27. Privatisation is a means to an end, but not an end in itself. We support the idea of privatisation because of the improvements in efficiency and customer outcomes that the process can deliver. However, we will continue to oppose poorly developed privatisation processes which are not structured to achieve these objectives.

Recommendation 4: That efficiency improvements are driven in the NSW networks by benchmarking their performance against the privately owned Victorian networks.

Recommendation 5: That the NSW Government completes a review into the potential costs and benefits around greater privatisation within the NSW electricity sector.

Emission reduction policies

28. Leaving aside the potential impact of a carbon price, existing emissions reduction policies from the State and Federal Government are already having a significant impact on electricity prices in NSW. IPART recently found that the costs of these green-schemes had increased four-fold since 1 July 2010, and that the Federal Government’s renewable energy target alone will add 6 percentage points to electricity prices in 2011-12.

29. The Grattan Institute and the Productivity Commission have both recently looked at the effectiveness of these programs, and both have found that they are generally very expensive ways of reducing emissions.

29.1. The Grattan Institute examined more than 300 different emissions reductions programs that had been implemented by State and Federal Governments in Australia over the last fifteen years. Their report found that grant-tendering programs had failed to deliver significant reductions, and that rebate programs were both ineffective and expensive.

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16 Grattan Institute, Learning the hard way: Australia’s policies to reduce emissions, April 2011, p. 3.
with most rebate programs estimated to cost well over $100 per tonne of emissions reduction, (and up to $400 per tonne in some cases).\(^{17}\)

29.2. The Productivity Commission review looked at 237 emission reduction policies in Australia.\(^{18}\) Their research found that the average cost of emissions reductions under these schemes was between $44 and $99 per tonne of emissions reduction.\(^{19}\)

30. Where the costs of these programs are passed on to electricity users they have a significant impact on costs while achieving only marginal environmental benefits.

31. In addition to their high costs, there appears to be limited coordination between and within different areas of State and Federal Government in the development of these programs. The effectiveness of these programs will be maximised if they can be simplified and streamlined, and if similar programs can be combined.

32. Increased complementarity between programs will result in greater clarity of targets and increase Australia’s ability to achieve sustained improvements in emissions intensity. More significantly for the economy and business, such complementarity will also reduce the complexity and regulatory burden of these programs.

**Recommendation 6:** That the impact of emissions reduction initiatives on electricity prices be transparently published as a component of total electricity prices.

**Recommendation 7:** That all levels of Government work collaboratively to streamline and reduce the complexity and regulatory burdens imposed by existing emissions reduction policies.

33. Should you require further information or clarification on any of these matters, then please do not hesitate to contact Mr Micah Green, Economist on (02) 9458 7259 or via e-mail at micah.green@nswbc.com.au.

Yours sincerely

Paul Orton
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\(^{17}\) Grattan Institute, *Learning the hard way: Australia’s policies to reduce emissions*, April 2011, p. 9.

\(^{18}\) Productivity Commission, *Carbon emission policies in key economies*, June 2011, p. 15.

\(^{19}\) ibid., p. xxvii.