Another approach to state asset sales programme

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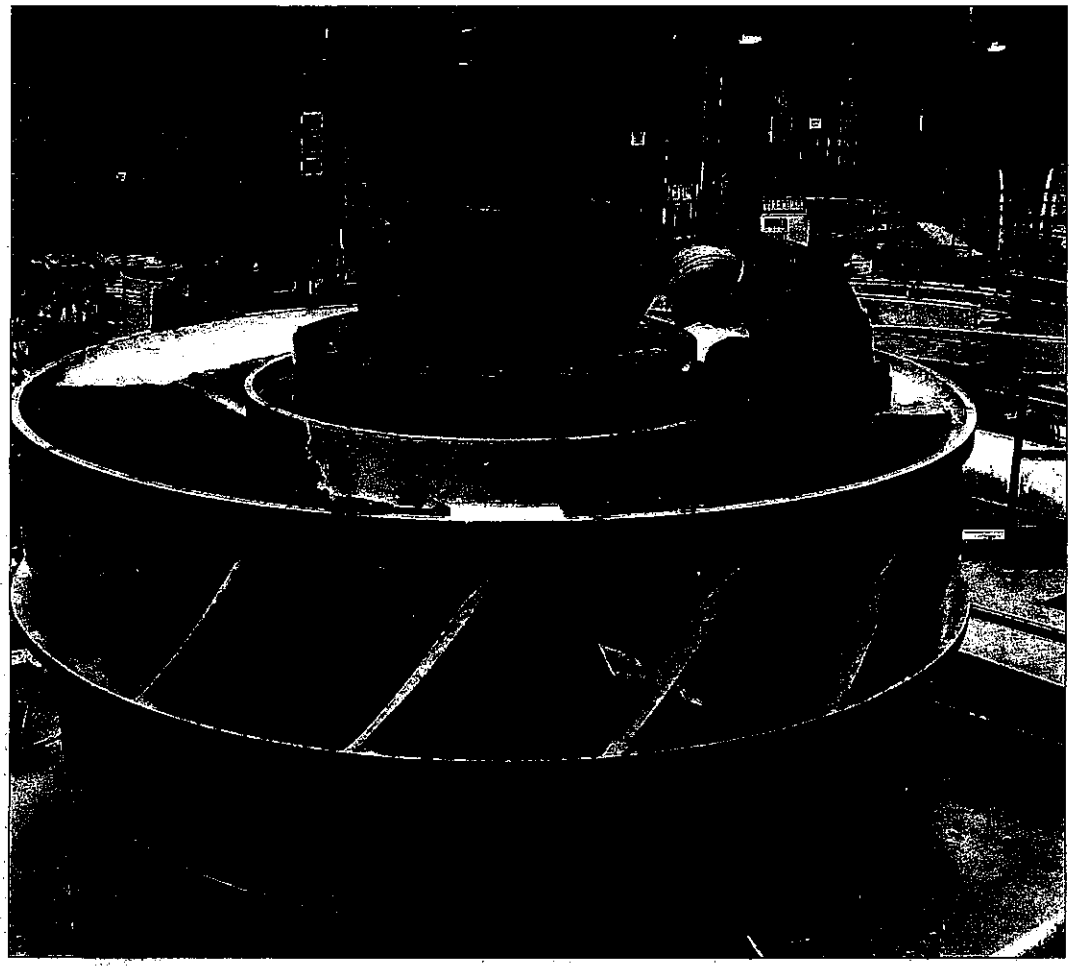

Power to the people: New Zealand's electricity industry used to have social objectives.

I WAS asked recently: "If you were prime minister, would you sell off New Zealand assets?" This was my response.

First some potted history. The New Zealand electricity system started off as a patchwork of local generation and distribution systems, but between 1914 and the 1930s it was converted into a state monopoly under William Massey and Gordon Coates, gaining huge "economies of scope and scale" from developing the system as an integrated whole.

Public ownership was the efficient way to achieve the socially desirable end of nationwide electrification at the least feasible cost, and New Zealanders took well-justified pride in their collectively owned system.

Until the 1980s, the electricity system was run for the benefit of consumers. That meant supplying electricity at cost price, not exploiting the monopoly's market power to fatten the Treasury's books. So electricity was priced on social principles, below the profit-maximising price, but still covering all its costs, effectively a social benefit in kind.

At both national and local levels, electricity pricing was subject to democratic control, through electric power boards, city councils, and the Electricity Ministry. Then came Roger Douglas and a neoliberal Treasury.

From a neoliberal point of view, state ownership is an anomaly. If privatisation is ruled out, state-owned operations should behave as profit-maximisers. Non-commercial social objectives have no place in the neoliberal vision and so should be subordinated to profit. If the Government wants socially responsible behaviour from state-owned enterprises, it has to pay for it. That's the State-Owned Enterprises Act 1986.

The other leg of the neoliberal double is deregulation. Since 1986, successive governments have left unchecked the predatory behaviour of the restructured electricity industry.

Consumers have been price-gouged, natural-monopoly positions have been exploited, and competitive market disciplines to innovate and change have been fought off by an industry that has successfully protected its de facto cartel against the arrival of independent generators, demand-side efficiencies, smart meters, smart grids, feed-in tariffs, lifeline tariffs – in short, most key innovations in the worldwide electricity industry since the 1980s.

Blocking progress while pushing prices up ahead of inflation has been highly profitable – and most of the profits have flowed into government coffers.

Treasury ministers accordingly have joined industry-linked officials and consultants to see off virtually all proposals for progressive change. The current asset sales programme will close off policy options that I favour in energy strategy and the future of electricity, first by reducing the scope for future governments to change course towards using the assets for socially desirable purposes, and second by increasing the power of private-sector interests to block progressive policy change.

But I concede the logic of the Government's approach. If the electricity SOEs are simply profit-seeking commercial ventures with no more sense of social responsibility than any private company, and if the Government's sole interest in them is to maximise its financial rake-off, it hardly matters whether the state holds the assets and collects dividends, or sells them and uses the value to undertake other projects.

So as prime minister, would I sell the assets?

Well, for me to have become prime minister, New Zealanders would have had to vote for a platform very different from that of Prime Minister John Key.

Key elements in my election platform would have been the following:

First off, the electricity assets that remain in state hands are still available for social purposes. With its existing generating stations plus the grid, the Government could undertake to supply all New Zealand households with a block of guaranteed electricity at a low price. Let's say the first 300 kilowatt hours each month are free.

The current asset sales programme will close off policy options that I favour in energy strategy.

There are about 1.7 million residential consumers, so that would be 6100 gigawatt hours a year, or a bit less than half of total residential electricity use. The saving to each household should be more than $750 a year.

That would make quite a difference to low-income households' health and welfare. Think of this as just like the Comalco power contract, but designed to transfer wealth from the Crown to residential consumers, rather than from New Zealand to a transnational.

Second, the Emissions Trading Scheme is basically a money-go-round, not a means of efficiently or effectively reducing New Zealand's carbon emissions. One issue with the ETS is that it charges us all $40 to $50 per tonne of emissions from generating electricity, compared to $12.50 per tonne (or less) on petrol.

Besides providing a perverse incentive for the economy to move away from renewables towards fossil fuels, the ETS fattens the profits of the owners of renewables-based power stations inherited from the old regime, by $200 million a year of windfall profits. My election platform would have included a proposal to tax all such windfall profits on sunk-cost capacity.

Price regulation of the electricity industry in New Zealand since the 1980s has been lax in lines companies and totally absent in generation and retail. Hence the ability of the companies to hike prices inexorably and to book the resulting profits without suffering any sanction. My election platform would have included a pledge to return to regulation of electricity prices on the basis of the historic cost of assets. This would imply a forced write-down of book values to eliminate unearned capital gains/revaluations.

There is an urgent need for new technology. We need small-scale renewable distributed generation by farms, households and businesses, with surplus power sold back into the grid at a price determined by a regulated feed-in tariff. We need genuinely smart metering. We need more independent generators. I would direct SOE boards to facilitate the entry of new technologies. With these key reforms in place, the "value" of the SOEs would be far below Finance Minister Bill English's guess of $6 billion. In fact it would be an interesting question whether private investors would want to buy the SOE assets, without the prospect of using market power to squeeze cash out of consumers and see off potential competitors.

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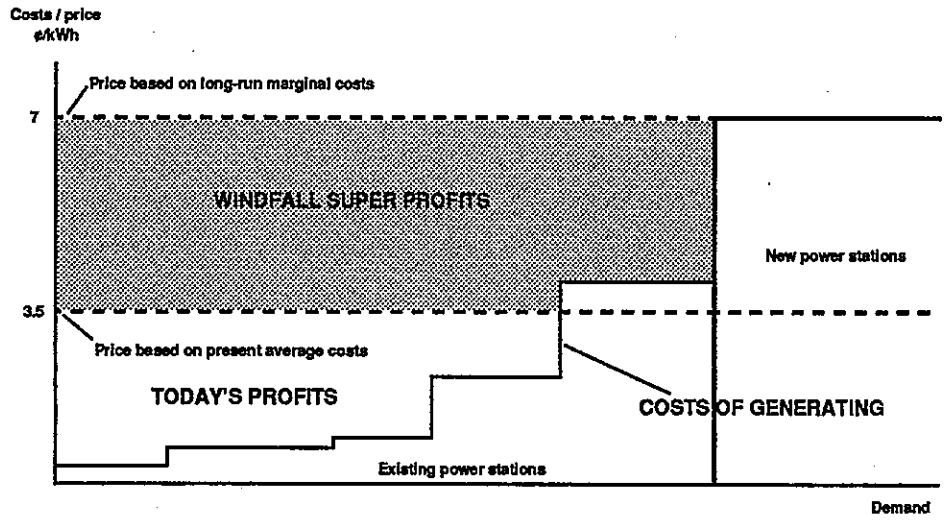
the community's spending power from one pocket to another: a simple financial transfer. A second-order effect would be some income redistribution from those with high electricity use and low net tax liability, to those with low electricity use and high tax liability.

Figure 6.1 Implications of Pricing Based on Long-Run Marginal Cost of 7 cents/kWh



Source: Adapted from Purchase, K., "New Zealand Electricity Supply: An Industrialist's Perspective", paper for Conference on Electricity Reform, Wellington, 2 December 1991.

6.3 Economic effects of an average-price increase

Such a price rise produces three real economic effects:

- First, new investment in generation (when required) and energy efficiency becomes more attractive, while demand growth is moderated as existing capacity becomes fully utilised. This outcome is in line with the declared aims of the electricity sector reforms.
- Second, the asset value of ECNZ rises as its cashflow and profits are driven up. This would raise the market value of the ECNZ assets, and so might be attractive to a government seeking maximum receipts from privatisation, but otherwise serves no economically useful purpose.
- Third, a higher relative price for electricity has economy-wide effects which are significant and undesirable. An increased electricity price forces consumers to spend a larger share of their budgets on electricity, with a contractionary effect on the aggregate economy. It is also built into firms' costs of production, squeezing their profitability and international competitiveness. These effects are analysed in detail in Chapter 10.