Australian Institute for Progress

The future does not look after itself

Qld Labor's Fiscal Strategy

Analysis

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1. Introduction

The Labor fiscal strategy gives voters the worst of both worlds – inferior returns from tax payer dollars, and higher electricity costs. It also diverts income from Government Owned Corporations already allocated in the budget to debt repayment, raising the question of how it will meet election commitments and commitments to unions regarding public sector conditions. With this money being diverted towards debt, what job creation schemes is the opposition proposing to meet their ambitious targets?

At the same time, given past performance, it is highly unlikely to ever be fully implemented, and government policies in the energy area are likely to impair the value of the assets over time.

Given the future prospects for the fossil fuel industry, and current buoyant conditions in capital markets, future capital losses on the assets incurred by holding, not selling, could easily outweigh the meagre cash flow savings the opposition expects.

Also by maintaining debt at high levels they rob themselves of the flexibility to use debt proactively, for the state's development. They also ignore the income generation possibilities of the government's plan of investing proceeds of asset sales in community infrastructure, as well as the confidence and flow-on effects of a potential construction program funded by part of the asset sales.

While they contrast their policy to pay down debt with the government's, and the government's spending priorities, the correct approach would have been to model their scenario against a range of scenarios and a benchmark rate of return. Instead they have started from the position that continuing to own the assets is the best possible use of taxpayers' money when it is likely a better business and consumer outcome would result from a different arrangement.

That they did not indicates this is not a serious piece of research and that Labor has not put enough thought into the asset sales proposition.

The policy has all the hallmarks of a document designed to answer the question "Where is your economic plan?", rather than, "What do you seriously intend to do?" It seems to arise from a presumption that the best answer is business as usual when the last 10 years of government in Queensland suggest this cannot be the right one.

Graham Young

Graham Young
Executive Director

2. A geared sovereign wealth fund

Labor's plan treats the power generating assets and ports as a geared business. That being the case they fail to ask the first questions that any investor should ask:

a. What are the returns on these assets?
b. What are the risks?
c. What is the opportunity cost?
d. Is it a good time to buy, or sell, assets of this type?

If they believe a geared sovereign wealth fund is the best use for the state's taxes, and the best way to pay back debt, then they should approach the issue in a similar way to the federal government's approach to the Future Fund, or the state government's approach to the QIC. The funds should be given to a competent manager, with full transparency, and a proper investment mandate. Assuming *a priori* that power and port assets are the best investment for the state is an almost completely amateur approach.

3. Community good aspects

Labor's plan does not consider the community good aspects in terms of the government ownership of port and electricity assets. Traditionally the only justification for the state owning assets of any sort is that they cannot be commercialised, or that there is a market failure which means the government must own them to ensure that consumers are not disadvantaged.

This raises the question of whether consumers get a better deal from government or private ownership of the assets. This matters not just from the point of view of consumers, but also because allowing assets to be owned and operated in the most efficient way increases community wealth, which will tend to increase the tax base and therefore government revenues.

While we are not aware of any studies on ports, the latest research on electricity networks in Australia, undertaken by Ernst and Young for the New South Wales Government, demonstrates that private ownership provides better returns to the consumer than government ownership. This can be demonstrated by comparing domestic electricity bills between Queensland, with publicly owned utilities and distribution, and Victoria and South Australia, with privately owned utilities and distribution, which Ernst and Young do in the graph below, taken from their report.

Table 3: Typical annual retail electricity bill ($ per year, nominal terms)

	Government-owned		Privately-owned	
	NSW 1996-97 to 2012-13	Qld 1996-97 to 2012-13	Victoria 1996 to 2013	SA 1998-99 to 2010-11
Current electricity bill	$1,925	$1,547	$1,495	$1,481
Electricity bill in 1996/1998	$745	$615	$752	$821
Increase in electricity bill	$1,180	$932	$743	$660
Current network bill	$1,069	$836	$595	$636
Network bill in 1996/1998	$343	$217	$368	$501
Increase in network bill	$726	$619	$227	$135

Source: EY

4. Price of financial assets above longterm trend

The ALP analysis concentrates on cash flow only, ignoring the influence of capital markets on the value of the assets. The world is currently experiencing an unprecedented boom, or possibly bubble, in financial assets, fed by quantitative easing. Given the stage in which the electricity industry finds itself, and a surplus of investment funds chasing returns, it is possible that the value of the assets to an investor is so high as to represent a windfall to the people of Queensland.

Indeed, the government hinted that they may realise even more from the assets than originally thought. This is possible, given the recent privatisation of Medibank Private at the top end of estimates, and the chart of the Dow Jones index below showing the US stock market at an historical high. Given the possibility of declining returns and historically low yields, this may indeed be the perfect time to sell assets, and delay may result in a capital loss that dwarfs the $1 b or so of dividends received from the assets.

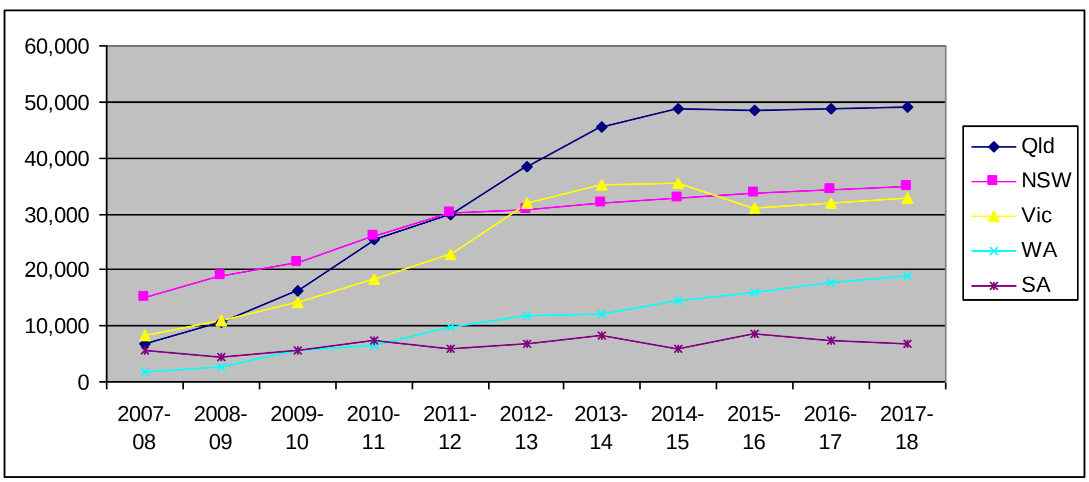
5. Can the Opposition stick to its repayment schedule?

There is a high risk that debt will not be repaid because the time horizon is too long. Reality is that governments can find many ways to change their financial priorities, and plenty of constituencies urging them to do so.

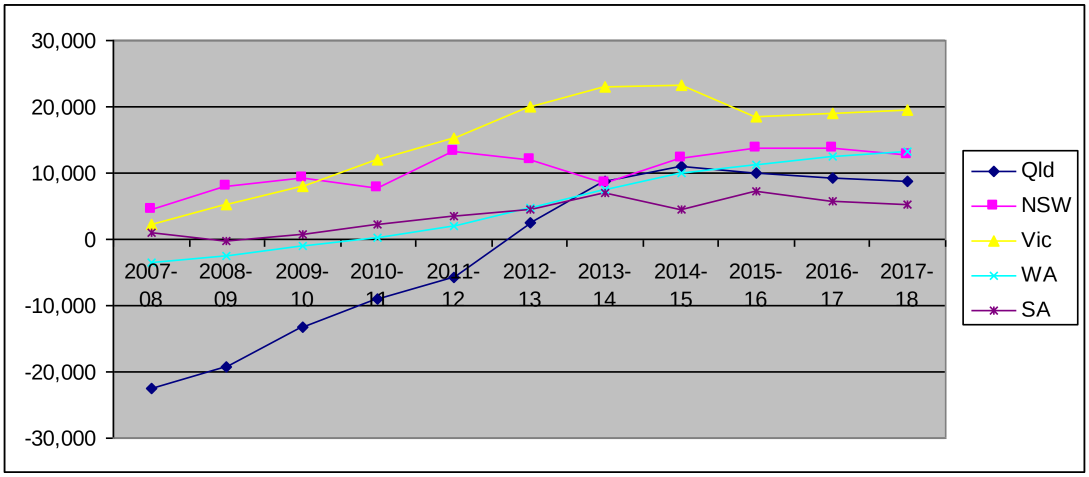
The LNP plan, by paying debt back immediately from sale of assets largely avoids this risk.

Labor's track record suggests they will find it impossible to discipline themselves. The last budget surplus in Queensland was 10 years ago, and the one predicted for this year is a skinny $188m. The graph shows that gross debt escalated from almost 6.833B in 2007-08 to 38.341B in 2012-13.

Newman has struggled to contain debt, but projections show that, without asset sales, it will only remain stable. The Opposition is asking the public to believe that they can do better than the Newman government, even though they have opposed most of the savings proposed by the government. For their proposal to be credible they must outline not only expenditure initiatives, but savings in the order of $12 bn over the next 10 years.



Net debt is even less flattering to the opposition. While it is currently in a better position than some of the other states, it was by far the richest state in 2007-08 with net assets of 22.598B. This was squandered in the late Beattie and Bligh governments. There is no reason to think that anything would change this time.


30,000
20,000
10,000
0
-10,000
-20,000
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2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
Qld
NSW
Vic
WA
SA

6. A Labor government would impair the value of the power assets

Based on Labor's previous policy stances the value of the power generating assets is likely to decline, while the cost of maintaining them is likely to rise. This is because Labor favours renewable energies such as solar and wind over existing fossil-fuelled electricity generation. These impact on the viability of generation and distribution assets, as well as imposing additional costs on them so as to adapt to the requirements of disruptive technologies, such as switching fuel sources from coal to gas, and upgrading networks to deal with electricity fed into the system from roof-top solar cells.

7. Opposition's proposed efficiencies captured by privatisation

The claimed reform of the generation and network businesses, projected to provide savings of $150m, may lift the return on the assets by around 10%, however, these savings are open to the government, and also potential purchasers, should they be worth doing. In which case, even if not implemented by the current owner, the government, they can be capitalised into the purchase price.

There is also a good argument that by combining the power generators the government would lessen competition, leading to an increase in power costs.

Corporate experience says that it is harder to achieve savings through mergers of different businesses than is often claimed by their proponents. It is a favourite ploy of stockmarket entrepreneurs, and has a mixed history. Without any sort of a study to back it up the savings have to be regarded as speculative and convenient.

8. Debt Reduction Trust a mirage

The “debt reduction trust” is at best a contrivance, and at worst a cap on the budget surpluses that the opposition intends to run. All that is necessary to pay back government debt is for the government to run a surplus each year. Any surplus will find its way into a decrease in net debt. It also implies less expenditure on other budget items than occurs at the moment, or would occur under the government’s plan, and that the Labor opposition would be able to cut these services more than the current government has, which given Labor’s opposition to any cuts, is implausible.